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Compilation and review engagements : essential questions and answers

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**AICPA Audit and Accounting
Practice Aid Series**

**Compilation and Review
Engagements—Essential
Questions and Answers**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA

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Practice Aid Series**

**Compilation and Review
Engagements—Essential
Questions and Answers**

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NOTICE TO READERS

This publication, *Compilation and Review Engagements—Essential Questions and Answers*, is a Practice Aid that provides CPAs with answers to frequently asked and key questions on practice issues and professional standards related to compilation and review engagements.

This Practice Aid is an Other Compilation and Review Publication as defined in Statement on Standards for Accounting and Review Services (SSARS) No. 11, *Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2, AR sec. 50). Other Compilation and Review Publications have no authoritative status; however, they may help the accountant understand and apply the SSARS.

If you apply the guidance included in an Other Compilation and Review Publication, you should be satisfied that, in your judgment, it is both appropriate and relevant to the circumstances of your engagement. This Practice Aid has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA, and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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1 2 3 4 5 6 7 8 9 0 AAG 0 9 8 7 6 5

TABLE OF CONTENTS

Acknowledgments.....	iv
Introduction.....	1
Standards and Guidance Associated With Compilations and Reviews.....	1
Other Sources of Guidance.....	5
General Questions About Compilation and Review Engagements	7
Questions About Accounting Principles.....	15
Questions About Engagement Administration.....	19
Questions About Compilation Engagements.....	27
Questions About Management-Use-Only Compilation Engagements.....	31
Questions About Prescribed Forms.....	35
Questions About Review Engagements.....	39
Questions About Reporting on Compiled or Reviewed Financial Statements	43
Questions About Supplementary Information.....	55
Questions About Fraud and Illegal Acts	59
Questions About Interim Financial Statements	61
Questions About Financial Statements Prepared on an Other Comprehensive Basis of Accounting	65
Questions About Personal Financial Statements.....	69
Appendix A—Other Sources of Information	71

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INTRODUCTION

This Practice Aid is the most extensive compendium of questions and answers about compilation and review services in the marketplace. The content was assembled by CPAs with extensive knowledge and experience in the compilation and review arena. The questions and answers were developed from inquiries received by the AICPA Accounting and Auditing Technical Hotline, the AICPA Technical Practice Aids, the AICPA Ethics division, and from the collective knowledge and experience of the authors.

STANDARDS AND GUIDANCE ASSOCIATED WITH COMPILATIONS AND REVIEWS

Engagements to compile or review financial statements of nonpublic entities are governed by Statements on Standards for Accounting and Review Services (SSARS), which are issued by the Accounting and Review Services Committee (ARSC). The ARSC is the senior technical committee of the AICPA designated to issue enforceable standards in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity.

The ARSC develops and issues standards in the form of SSARS through a due process that includes deliberations in meetings open to the public, public exposure of proposed SSARS, and a formal vote. You should have sufficient knowledge of the SSARS to identify those that are applicable to your engagement. The nature of the SSARS requires you to exercise professional judgment in applying them and you should be prepared to justify departures from the SSARS. The ARSC has issued the pronouncements listed below. This Practice Aid reflects SSARS issued through SSARS No. 11.

- SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100) (December 1978)
 - Defines the *compilation of financial statements* and the *review of financial statements* of a nonpublic entity and provides guidance to accountants concerning the standards and procedures applicable to such engagements.
- SSARS No. 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200) (October 1979)
 - Establishes standards for reporting on comparative financial statements of a nonpublic entity when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with SSARS No. 1.

- SSARS No. 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300) (December 1981)
 - Amends SSARS No. 1 and No. 2 to provide for an alternative form of standard compilation report when a prescribed form or related instructions call for departure from generally accepted accounting principles (GAAP) by specifying a measurement principal not in conformity with GAAP or failing to request the disclosures required by GAAP. It applies to any standard, preprinted form designed or adopted by the body to which it is submitted (for example, a bank).
- SSARS No. 4, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, vol. 2, AR sec. 400) (December 1981)
 - Provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity. It also provides guidance on inquiries a successor accountant may wish to make of a predecessor, and the predecessor's responses, to facilitate the conduct of the successor's compilation or review engagement. It also requires a successor accountant who becomes aware of information that leads him or her to believe the financial statements reported on by the predecessor accountant may require revision to request that the client communicate this information to the predecessor accountant. It does not require communication.
- SSARS No. 5, *Reporting on Compiled Financial Statements* (July 1982) (Deleted November 1992 by the issuance of SSARS No. 7)
 - All the former SSARS No. 5 requirements are now included in AR sections 100, 200, and 300 of the *Codification of Statements on Standards for Accounting and Review Services*.
- SSARS No. 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AICPA, *Professional Standards*, vol. 2, AR sec. 600) (September 1986)
 - Provides an exemption from SSARS No. 1, as amended, for personal financial statements that are included in written personal financial plans prepared by the accountant, and specifies the form of written report required under the exemption.
- SSARS No. 7, *Omnibus Statement on Standards for Accounting and Review Services—1992* (November 1992)
 - Clarifies the applicability of SSARS No. 1 by indicating that in certain circumstances, an accountant may perform a review of a public company under the provisions of SSARS.
 - Inserts a footnote in paragraph 4 of SSARS No. 1 to indicate that the definition of generally accepted accounting principles and the hierarchy of established accounting principles presented in SAS No. 69, *The Meaning of Present Fairly in Conformity With Generally*

- Accepted Accounting Principles (AICPA, *Professional Standards*, vol. 1, AU sec. 411), as amended, is also applicable to compilations and reviews of financial statements performed under SSARS. It also expands an existing footnote to paragraph 4 to indicate the source of guidance for evaluating the adequacy of disclosure in financial statements prepared in conformity with a comprehensive basis of accounting other than GAAP. It also adds a footnote to paragraph 4 that informs the reader of sources of guidance for preparing and reporting on financial forecasts, projections, and similar presentations.
- Eliminates the prohibition against merely typing or reproducing financial statements as an accommodation to a client and defines the phrase “submission of financial statements.”
 - Makes explicit that the accountant is not required to communicate to a client errors that are not material and irregularities or illegal acts that are clearly inconsequential.
 - Revises the SSARS review report to differentiate it from the review report presented in SAS No. 71, *Interim Financial Information*.
 - Makes obtaining a client representation letter a required, rather than optional, procedure when performing a review engagement under SSARS.
 - Clarifies the accountant’s reporting responsibilities in a compilation or review engagement when he or she decides there is uncertainty about an entity’s ability to continue as a going concern.
 - Clarifies the guidance in paragraphs 44 through 49 of SSARS No. 1 concerning a change in engagement from audit to review or compilation to indicate that the guidance in those paragraphs is also applicable to a change in engagement from review to compilation.
 - Modifies the introductory paragraph of SSARS No. 4 to inform the reader that the Statement provides guidance on required as well as optional communications between a successor and a predecessor accountant.
 - Deletes footnote 2 of paragraph 3 of SSARS No. 4 because that footnote is inconsistent with SAS No. 7, *Communications Between Predecessor and Successor Auditors*.
 - Deletes SSARS No. 5 because the provisions of that Statement have been incorporated into SSARS No. 1, No. 2, and No. 3.
- SSARS No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements* (October 2000)
 - Amends SSARS No. 1 to create new options for accountants when performing compilation engagements in which the financial statements are not expected to be used by a third party, and also allows the accountant to use his or her professional judgment in dealing with the client.

- SSARS No. 9, *Omnibus Statement on Standards for Accounting and Review Services—2002* (November 2002)
 - Revises SSARS No. 1 to include wording that may be appropriate when an accountant is associated with financial statements of a nonpublic entity, but has not compiled or reviewed such statements.
 - Revises SSARS No. 1 to state that (1) the statement of retained earnings is not a required statement and, if not presented as a separate statement, reference in the compilation and review report is not needed and (2) if the statement of comprehensive income is presented, reference should be made to the appropriate paragraphs of the report.
 - Revises SSARS No. 1 to require a signature of the accounting firm or the accountant on a review or compilation report.
 - Requires specific representations for the accountant to receive from management when performing a review engagement and provides guidance on the dating of the representation letter from management and guidance regarding obtaining representations from the current management when they are not present during all periods covered by the accountant's report.
 - Explicitly allows for a separate report on supplementary information in a compilation engagement, consistent with guidance on supplemental information in a review report.
 - Clarifies that although an effective quality control system is conducive to compliance with SSARS, deficiencies in or noncompliance with a firm's quality control systems do not, in and of themselves, indicate that an engagement was not performed in accordance with the applicable professional standards.
 - Defines *predecessor accountant* and *successor accountant*, provides guidance regarding the acceptance of an engagement, suggests inquiries the successor accountant may decide to ask the predecessor accountant, and includes an example successor accountant acknowledgment letter, which the predecessor may want to use in connection with granting access to the engagement documentation.
- SSARS No. 10, *Performance of Review Engagements* (May 2004)
 - Amends SSARS No. 1 by expanding on previously provided guidance on analytical procedures, inquiries, and other review procedures Provides inquiries regarding fraud in a review engagement.
 - Requires representations regarding fraud in the management representation letter.
 - Clarifies and provides guidance regarding documentation in a review engagement.

- SSARS No. 11, *Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2, AR sec. 50) (May 2004)
 - Establishes a “SSARS Hierarchy.”

Other Sources of Guidance

Interpretative Publications

Interpretative publications consist of Interpretations of the SSARS and appendixes to the SSARS, compilation and review guidance included in AICPA Audit and Accounting Guides, and AICPA Statements of Position (SOP), to the extent that those SOPs are applicable to compilation and review engagements. Interpretative publications are not standards for accounting and review services but are recommendations on the application of the SSARS in specific circumstances. You should be aware of and consider interpretative publications applicable to your compilation or review. If you do not apply the guidance included in an applicable interpretative publication, you should be prepared to explain how you complied with the SSARS provisions addressed by such guidance.

Other Publications

Other compilation and review publications include AICPA accounting and review publications not referred to above; the AICPA’s annual *Compilation and Review Alert*; compilation and review articles in the *Journal of Accountancy* and other professional journals; compilation and review articles in the *AICPA CPA Letter*; continuing professional education programs and other instruction materials, textbooks, guide books, compilation and review programs, and checklists; and other compilation and review publications from state CPA societies, other organizations, and individuals. The accountant is not expected to be aware of the full body of other compilation and review publications. These publications have no authoritative status; however, they may help you understand and apply the SSARS.

If you apply the guidance included in an other compilation and review publication, you should be satisfied that, in your judgment, it is both relevant to the circumstances of the engagement, and appropriate. Other compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate. This publication has been reviewed by the Audit and Attest Standards staff.

GENERAL QUESTIONS ABOUT COMPILATION AND REVIEW ENGAGEMENTS

Question—Does an accountant have to be a member of the AICPA to perform compilation and review engagements? Does the accountant have to be a CPA or a public accountant?

Answer—SSARS do not address the issue of AICPA membership as a requirement for compiling or reviewing financial statements of a nonpublic entity. However, one element of the compilation and review report is a statement that the compilation (review) has been “performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.” In addition, many state boards of accountancy restrict the performance of compilation and review engagements to CPAs. You should check with the board of accountancy in your state for guidance on this issue.

Question—May an accountant use paraprofessionals in a compilation or review engagement?

Answer—Yes. You may use assistants (including paraprofessionals) in a review or compilation engagement, assuming the assistants are competent. However, Rule 201C, *General Standards* (AICPA, *Professional Standards*, vol. 2, ET sec. 201.01) states that you should “adequately plan and supervise the performance of professional services.” In addition, Interpretation No. 5, “Planning and Supervision,” of SSARS No. 1 (AR sec. 9100.16–.17) notes that although SAS No. 22, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 311), does not govern compilation and review engagements, you may wish to consider the guidance in SAS No. 22 when additional information on planning and supervision is needed. Of course, you, as the accountant, must sign the compilation or review report and thus take responsibility for the entire engagement, including the work of any assistants, and any assurance provided in the accountant’s report.

Question—A client has asked that an accountant read its client-prepared financial statements and propose correcting journal entries and disclosures to the financial statements that would change the financial statements. The accountant will not directly modify the financial statements. Would this be considered submitting financial statements? How should these correcting journal entries and disclosures be communicated to the client? Can they be communicated orally or in written form?

Answer—SSARS No. 1 (AR sec. 100.04) defines *submission of financial statements* as “presenting to a client or third parties financial statements that the accountant has prepared either

manually or through the use of computer software.” Reading client-prepared financial statements and proposing correcting journal entries, disclosures, or both would not meet the definition of submitting financial statements, since these services do not constitute preparing financial statements. Therefore, these journal entries and disclosures could be communicated to the client in any way that you choose. They could be communicated orally or in written form.

Question—Refer to the previous question and assume that these statements will be transmitted to a bank. The bank has requested that the accountant attach a letter stating there are no material adjustments to be made to the client-prepared financial statements. May the accountant attach such a letter?

Answer—No. You should not attach such a letter to client-prepared financial statements. Based on simply proposing correcting journal entries and disclosures and reading the client-prepared financial statements, you would not be in a position to express such assurance on the financial statements. If the client, the bank, or both needed assurance on the financial statements, you would need to review or audit the financial statements and issue the appropriate report.

Question—A CPA firm has been engaged to perform accounting functions for a client. The functions include recording transactions in the client’s accounting system, preparing checks, and preparing various monthly and quarterly reconciliations. At year end, the CPA firm also prepares GAAP basis financial statements, which are then audited by another CPA firm. Must a compilation report be issued for the year-end financial statements?

Answer—Yes. According to Interpretation No. 21, “Applicability of SSARS No. 1 When Performing Controllorship or Other Management Services” of SSARS No. 1 (AR sec. 9100.80–.84), if you are in the practice of public accounting and are not a stockholder, partner, director, officer, or employee of the entity and provide the entity with services such as those above, you must follow the performance and communication requirements of SSARS No. 1 (AR sec. 100), including any requirement to disclose a lack of independence.

Question—Using client information, the accountant prepares financial statements in the CPA’s office for use in preparing a corporate income tax return, and the financial statements are not given to the client. Is this considered submission of financial statements?

Answer—No. SSARS No. 1 (AR sec. 100.04) defines *submission of financial statements* as “presenting to a client or third parties financial statements that the accountant has prepared either

manually or through the use of computer software.” Since the financial statements are not presented to the client or others, the financial statements are not submitted and SSARS No. 1 would not apply.

Question—A firm recently installed a server that will enable some of its clients to access the firm’s computer system via a network. The client will input all information into the firm’s computer system, including journal entries, and will be able to prepare its own financial statements, which will be received via the network. No one in the accounting firm directly inputs data or sees the financial statements. Is the accounting firm required to compile these financial statements in accordance with SSARS No. 1?

Answer—No. According to AICPA Technical Practice Aids (TPA) section 9150.11, “Computer Generated Financial Statements,” if the client directly inputs data from its office, you do not have a reporting responsibility.

Question—Assume the same facts as in the previous question, but the CPA firm posts journal entries and generates the financial statements in the CPA firm’s office. Is the accounting firm required to compile these financial statements in accordance with SSARS No. 1?

Answer—Yes. According to TPA section 9150.11, if the financial statements are generated in the firm’s office and presented to the client or others, you would be required to compile and report on the financial statements in accordance with SSARS No. 1.

Question—Can an accountant accept a compilation or review engagement that includes only a single financial statement?

Answer—Yes. SSARS No. 1 (AR sec. 100.15 and 100.43) states that you are not precluded from doing so. Therefore, you can compile a single financial statement or review a single financial statement if the scope of your inquiry and analytical procedures has not been restricted. However, when you compile or review only one financial statement but a complete set of financial statements is presented, the financial statements that were not compiled or reviewed should be accompanied by an indication that you did not compile or review those financial statements and that you assume no responsibility for them. For example, the indication may be worded as follows:

This financial statement has not been audited, reviewed, or compiled by [name of CPA]. For this reason, the CPA accepts no responsibility for the preparation of the financial statement and provides no assurance that the financial statement is prepared in accordance with GAAP.

Question—What procedures should be applied if the accountant becomes aware that facts may have existed at the date of the accountant’s compilation or review report that might have caused him or her to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had the accountant been aware of such facts?

Answer—SSARS No. 1 (AR sec. 100.48) notes that under this circumstance, standards established in SAS No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 561, “Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report”), as amended, may be applied in the context of a compilation engagement or review engagement. Based on the guidance in SAS No. 1 (AU sec. 561), you are under no obligation to perform additional procedures after the date of the report, unless new information comes to your attention that suggests the financial statements may be incorrect.

When you become aware of matters that appear to have existed at the date of the report, you should contact the client to determine whether those matters did in fact exist at that date. According to Interpretation No. 4, “Discovery of Information After the Date of the Accountant’s Report,” of SSARS No. 1 (AR sec. 9100.13–15), if you conclude that the matter did exist at the report date, you should determine whether the following conditions apply:

- The report would have been affected if you had known the information at the date of the compilation report.
- The matter would have been reflected in the financial statements.
- You believe that there are third-party users relying on or likely to rely on the financial statements who would attach importance to the subsequently discovered information.

Because of legal implications involved in these actions, you should consider consulting with an attorney before proceeding.

If the conditions previously described exist, you should advise the client to fully inform third-party users currently relying or likely to rely on the financial statements and the associated report of the subsequently discovered facts and their impact.

You should take appropriate steps to determine that the client has communicated properly with third-party users. If the client refuses to make appropriate disclosures to third-party users, you should inform each member of the board of directors of the refusal. (In the event that the client does not have a board of directors, you should inform legal counsel). If the board of directors is

notified but appropriate disclosures to third-party users still are not made, you should discuss the matter with legal counsel. If you believe there are or will be third-party users who will rely on the financial statements and the associated report and who would attach importance to the information, you should take steps to prevent reliance on your report.

Although a compilation report does not express any form of assurance on the financial statements, it would seldom be appropriate for an accountant to conclude, simply because his or her responsibilities were limited to a compilation service, that notification of third-party users in the absence of notification by the client is not required when the accountant knows that the financial statements should be revised.

Question—An accountant compiles financial statements with substantially all disclosures omitted. The accountant drafts a comprehensive engagement letter indicating that detection of fraud is not the accountant’s responsibility. In this litigious society, the accountant wants to make this agreement with his or her client clear not only to the client, but also to any third party that uses the compilation report. Could the accountant attach a copy of the engagement letter directly to the financial statements as “supplementary information”? Could the accountant reference the engagement letter or his or her lack of responsibility for fraud detection in the compilation report?

Answer—No. Even though footnote 23 of SSARS No. 1 (AR sec. 100.46) states, “Nothing in this statement, however, is intended to preclude an accountant from emphasizing in a separate paragraph of his or her report a matter *regarding the financial statements*” (emphasis added), the engagement letter is a contract between you and your client and, as such, is not a matter regarding the financial statements. Rather, it is a matter regarding the nature of the compilation engagement. Therefore, it would not be appropriate to make such a reference in your compilation report. However, nothing in SSARS precludes you from attaching a copy of the engagement letter to the compilation report when you deliver the report to the client. However, the client may remove the engagement letter when the client submits the report and the related financial statements to third parties.

Question—A CPA who is a controller for a privately held company wants to issue compiled financial statements and attach a compilation report for the company. May the controller use the standard compilation report?

Answer—Interpretation No. 21 of SSARS No. 1 (AR sec. 9100.80–.84) states that if you are in the practice of public accounting and also a stockholder, partner, director, officer, or employee of the entity, you may either (1) comply with the requirements of SSARS No. 1 (AR sec. 100), or

(2) communicate, preferably in writing, your relationship to the entity. Interpretation No. 21 provides the following example of the type of communication that may be used:

The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by [*name of accountant*], CPA. I have prepared such financial statements in my capacity as [*describe capacity, for example, as a director*] of Company X.

If an accountant is not in the practice of public accounting, the issuance of a report under SSARS would be inappropriate; however, the above communication may be used.

Question—An accountant has been contacted by a potential new client to compile financial statements for the year ended December 31, 20XX. The financial statements for the same period were audited by another accounting firm. The client argues that the inventory number reported in the audited financial statements is incorrect and has engaged an outside firm to count the inventory. The client is requesting that the accountant compile the financial statements using the re-counted inventory amount. Can the accountant agree to its request?

Answer—Yes. However, you would have to consider, based on your professional judgment, whether the changed inventory number is a reasonable justification to change the engagement (given that the cost to the client of having the predecessor firm reaudit the inventory number presumably would not be significant). In addition, you would have several responsibilities in this situation. First, SSARS No. 4 (AR sec. 400.10), requires that you request the client to communicate this information to the predecessor accountant. In addition, you should advise the client to fully inform third-party users currently relying or likely to rely on the financial statements and the associated report of the subsequently discovered facts and their impact. If the client refuses to communicate with the predecessor accountant and third parties or if you are not satisfied with the predecessor accountant's course of action, you should not agree to compile the financial statements. Finally, if you compile and report on the restated prior-period financial statements, you should not refer to the predecessor's previously issued report.

Given the nature of the client's request, you should strongly consider communicating with the predecessor accountant in accordance with SSARS No. 4 before the acceptance of the engagement to compile the financial statements.

Question—An accountant has been retained by a client whose financial statements at December 31, 20X1, were audited by another CPA firm. The accountant has been engaged to review the financial statements at December 31, 20X2. An error in the audited financial statements resulted in income being overstated. The prior auditor has written a letter to all known users of the statements indicating the financial statements are incorrect and cannot be relied upon. Before the ac-

accountant begins the review engagement, the opening balance sheet needs to be adjusted for the errors at December 31, 20X1. Would it be appropriate to compile the financial statements at December 31, 20X1, to reflect the correct opening balances?

Answer—Yes. SSARS No. 2 (AR sec. 200.25) states that either the predecessor or the successor accountant should report on the changed prior-period financial statements as restated. If you compile and report on the restated prior-period financial statements, you should not refer to the predecessor’s previously issued report. Further, SSARS No. 2 (AR sec. 200.26) states that you may wish to include an explanatory paragraph in your compilation report with respect to the restatement, but you should not otherwise modify the standard compilation report, provided the financial statements appropriately disclose such matters.

Question—An accountant has been engaged to compile or review the financial statements of an entity and is later requested to perform a higher level of service with respect to the financial statements. Is the acceptance of such an engagement appropriate?

Answer—Yes. SSARS No. 1 (AR sec. 100) does not prohibit you from accepting an engagement to perform a higher level of service with respect to financial statements that have been previously compiled or reviewed.

Question—A client is trying to secure financing from a bank. The bank has required audited financial statements to secure the financing. During the course of the audit, the bank agrees that audited financial statements are not necessary. Is it appropriate to change the level of service to a review?

Answer—Yes. SSARS No. 1 (AR sec. 100.52) states that a change in circumstances that affects the client’s requirement for an audit (or review) would ordinarily be considered a reasonable basis for requesting a change in the level of service.

Question—SSARS No. 1 (AR sec. 100.13 and 100.40) states that each page of the financial statements compiled or reviewed by the accountant should include a reference such as “See Accountant’s Compilation or Review Report.” Does this requirement extend to the related notes of the financial statement?

Answer—Yes. SSARS No. 1 (AR sec. 100.04) defines *financial statement* as “a presentation of financial data, including accompanying notes, derived from accounting records and intended to

communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principals (GAAP) or a comprehensive basis of accounting other than GAAP" (footnotes omitted). Therefore, the statement that each page of the financial statements compiled or reviewed should include a reference such as "See Accountant's Compilation (or Review) Report" extends to the accompanying notes.

Question—Should each page of compiled or reviewed financial statements of nonpublic companies be labeled "unaudited"?

Answer—No. SSARS do not require that each page of the financial statements be labeled "unaudited." Before the issuance of SSARS No. 1 (AR sec. 100), it was common practice to label each page as "unaudited"; however, this practice was discontinued after the issuance of SSARS No. 1 because the term *unaudited* does not convey to the reader the financial statement service performed.

Question—An accountant has been compiling full disclosure GAAP financial statements for a client for several years. The client has recently expressed concern about the cost for these services. Are there other options to full disclosure GAAP financial statements?

Answer—Yes. You could offer any or a combination of the following services to the client, depending on its needs. Each of these options, depending on the firm's fee structure and the nature of the engagement, may be less costly than full disclosure GAAP financial statements.

- OCBOA financial statements (time savings on measurement issues)
- Compiled financial statements with substantially all disclosures omitted
- Compiled financial statements for management's use only

QUESTIONS ABOUT ACCOUNTING PRINCIPLES

Question—Do different GAAP apply to audited financial statements and compiled or reviewed financial statements?

Answer—No. Footnote 5 of SSARS No. 1 (AR sec. 100.04) states that the definition of GAAP and the hierarchy of established accounting principles presented in SAS No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* (AICPA, *Professional Standards*, vol. 1, AU sec. 411), is also applicable to compiled and reviewed financial statements.

Question—Is a statement of cash flows required for every period in which an income statement is presented?

Answer—A statement of cash flows is required by GAAP. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows*, states that “a business enterprise that provides a set of financial statements that reports both financial position and results of operations shall provide a statement of cash flows for each period for which results of operations are provided.” However, Interpretation No. 14, “Evaluating the Adequacy of Disclosure in Financial Statements Prepared on the Cash, Modified Cash, or Income Tax Basis of Accounting,” of SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 9623.94), states that a statement of cash flows is not required in presentations using the cash, modified cash, or income tax basis of accounting. In addition, the statement of cash flows may be omitted, even if required, in compiled financial statements if the omission is clearly indicated in the compilation report and is not, to the accountant’s knowledge, undertaken with the intent of misleading those who might reasonably be expected to use such financial statements.

Question—A client has found that complying with FASB Statement No. 142, *Goodwill and Other Intangible Assets*, is cost prohibitive. What options does the client have?

Answer—FASB Statement No. 142 requires that goodwill be tested annually for impairment rather than amortized to earnings. Many small businesses have found that the costs associated with performing the annual test impairment far exceed the benefit of the test. Therefore, if a client opts not to adopt FASB Statement No. 142 (or any other FASB Statement), you should consider whether modification of the standard compilation or review report is adequate to disclose

the departure. If you conclude that modification of the standard compilation or review report is appropriate, the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of your procedures. You are not required to determine the effects of a departure if management has not done so, provided that you state in your report that such determination has not been made.

Question—What is the accountant’s responsibility for GAAP departures discovered during the course of a compilation or review engagement?

Answer—You should discuss the GAAP departure with the client. If the client does not revise the financial statements, the GAAP departure should be referenced in the compilation or review report. If you believe that modification of the standard report is not sufficient to indicate the deficiencies in the financial statements taken as a whole, you should consider withdrawing from the compilation or review engagement and provide no further services with respect to those financial statements. You may wish to consult with your legal counsel in those circumstances.

Question—Can the accountant modify the compilation or review report to indicate that the financial statements are not fairly presented in conformity with GAAP (or an other comprehensive basis of accounting (OCBOA))?

Answer—No. Expressing such a conclusion in a compilation or review report would be tantamount to an adverse opinion on the financial statements taken as a whole. Interpretation No. 7, “Reporting When There Are Significant Departures From Generally Accepted Accounting Principles,” of SSARS No. 1 (AR sec. 9100.23–.26) states that such an opinion can be expressed only in the context of an audit engagement.

Question—Is a statement of retained earnings required? Should the omission of the statement of retained earnings be referred to in the report?

Answer—Accounting Principles Board (APB) Opinion No. 9, *Reporting the Results of Operations*, states that the statement of income and the statement of retained earnings (separately or combined) are designed to reflect, in a broad sense, the “results of operations.” Therefore, to present results of operations under GAAP, changes in retained earnings must be disclosed. Based on Interpretation No. 14 of SAS No. 62 (AU sec. 9623.90), OCBOA financial statements also should disclose the changes in retained earnings when results of operations are presented. This

disclosure can be made in a separate financial statement, in the notes to the financial statements, or as part of another basic statement (such as the income statement or balance sheet). As long as the change in retained earnings is disclosed in one of these ways, there is no need to refer to the omission of a statement of retained earnings.

Question—Must the accountant present a separate statement of comprehensive income? If an accountant compiles full disclosure financial statements, but omits the display of comprehensive income, is that considered a departure from GAAP?

Answer—According to FASB Statement No. 130, *Reporting Comprehensive Income*, all business entities that have any component of other comprehensive income must display information about comprehensive income in a financial statement having the same prominence as the other basic financial statements. If an entity does not have any components of other comprehensive income, FASB Statement No. 130 does not apply. As a result, most small business clients do not have to apply FASB Statement No. 130.

FASB Statement No. 130 does not specify a format for presenting comprehensive income, although it provides three examples:

1. Presenting the information in the income statement (after net income)
2. Presenting the information in the statement of changes in equity
3. Presenting the information in a separate statement of comprehensive income

The wording of the introductory paragraph of the compilation or review report may have to be modified depending on how you choose to report comprehensive income. If comprehensive income is reported in the income statement, the title of the statement will need to be modified (Statement of Income and Comprehensive Income). If comprehensive income is reported in the statement of changes in equity, no modification to the report is necessary. If comprehensive income is reported in a separate statement, an additional statement will need to be referenced in the report.

In addition, Interpretation No. 25, “Omission of the Display of Comprehensive Income in a Compilation,” of SSARS No. 1 (AR sec. 9100.95–.99) states that the display of comprehensive income may be omitted when the accountant issues a compilation report with substantially all disclosures omitted by identifying the omission in the compilation report or engagement letter (for a management-use-only compilation). If the accountant compiles financial statements that include all disclosures but omit the display of comprehensive income, the omission should be treated as a departure from GAAP.

Additionally, if an element of comprehensive income has not been computed, for example, unrealized gains and losses arising from investments in marketable securities classified as “available for sale” the accountant should consider a departure from GAAP and follow the guidance in SSARS No. 1 (AR sec. 100.45–.47).

QUESTIONS ABOUT ENGAGEMENT ADMINISTRATION

Question—Can an accountant review a client’s financial statements if he or she is not independent?

Answer—No. You are prohibited from issuing a review report if you are not independent.

Question—Can an accountant compile a client’s financial statements if he or she is not independent?

Answer—Yes. However, the compilation report must disclose the lack of independence. The reasons for the lack of independence should not be disclosed, according to SSARS No. 1 (AR sec. 100.19). However, it may be appropriate to explain the reasons for your lack of independence to the client or third parties, either orally or in a transmittal letter.

Question—If an AICPA member performs routine bookkeeping services for a review or compilation client, what is the level of understanding that the client designee should possess to comply with Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule of Conduct 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05)?

Answer—Where the member performs routine bookkeeping services for a review or compilation client, the member should be satisfied that the designated individual understands the reason why the journal entries are being proposed and the effect they have on the financial statements. For recurring or standard journal entries (for example, depreciation), the designated individual may require no explanation as to the reason for the entry (for example, where the member has previously discussed these entries with the client), whereas for more complex journal entries (for example, deferred taxes), the member may need to explain to the client the reason and basis for the entry and its impact on the financial statements. In any case, the individual should be in a position to approve the proposed journal entries and accept responsibility for the company’s financial statements.

Question—One of the requirements of Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule of Conduct 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), is that, prior to performing nonattest services for an attest client, the member should establish and document in writing his or her understanding with the client regarding the:

- Objectives of the engagement
- Services to be performed
- Client’s acceptance of its responsibilities
- Member’s responsibilities
- Any limitations of the engagement

How does this documentation requirement affect compilation and review services?

Answer—The documentation requirement applies to any nonattest services (for example, bookkeeping, tax, or consulting services) performed by the member for an attest client. For purposes of this rule, an “attest client” is any client for which the member performs any service for which independence is required. Accordingly, for purposes of this rule, a client for which a member performs a compilation would only be considered an attest client if the member’s compilation report does not disclose a lack of independence. In cases where a member only provides nonattest services to a client, the general requirements of the interpretation, including the documentation requirement, are not effective until the client becomes an attest client. For example, if a member provides only tax planning and bookkeeping services for a client and is subsequently asked to perform a review of the client’s financial statements, that member could perform such services if, upon acceptance of the review engagement, he or she prepares the required documentation and can demonstrate that he or she has complied with the other general requirements of the Interpretation during the period covered by the financial statements, including the requirement to establish an understanding with the client regarding the matters identified above.

Question—When a successor accountant decides to contact a predecessor accountant, is it necessary to obtain permission from the client? Must the permission be in written form?

Answer—SSARS No. 4 (AR sec. 400.04) requires that the successor accountant request permission from the prospective client before contacting the predecessor accountant. The permission from the client does not have to be in written form.

Question—Are there any requirements for communications between successor and predecessor accountants in a review or compilation engagement?

Answer—Unlike the auditing standards, SSARS do not require a successor accountant to communicate with the predecessor accountant. However, if the successor accountant decides to communicate with the predecessor accountant, SSARS No. 4 (AR sec. 400) provides guidance on the communications.

Question—During the course of a review engagement, the accountant discovers that the prior-period financial statements reported on by another accountant are in error. What should the accountant do?

Answer—SSARS No. 4 (AR sec. 400.10) requires that you request the client to communicate this information to the predecessor accountant. If the client refuses to communicate with the predecessor accountant or if you are not satisfied with the predecessor accountant's course of action, you should evaluate (1) possible implications for the current engagement and (2) whether to resign from the engagement. Furthermore, you may decide to consult with legal counsel in determining an appropriate course of further action. Finally, if you compile or review and report on the restated prior-period financial statements, you should not refer to the predecessor's previously issued report.

Question—An accountant was engaged to review financial statements and prepare the entity's corporate tax return. The most recent tax return is under audit by the IRS and the client has withheld paying the accountant's fee. The accountant has made several attempts to collect the fee but the client is unsatisfied and has decided to retain a new accounting firm. Since the fee remains unpaid, must the accounting firm respond to the successor accountant's inquiries and allow access to the working papers?

Answer—SSARS No. 4 (AR sec. 400.06) states that the predecessor accountant should respond promptly and fully to the successor accountant's inquiries, on the basis of known facts. However, the predecessor accountant may decide, due to unusual circumstances, not to respond fully to the inquiries. SSARS No. 4 (AR sec. 400.06) states that for the purposes of this communication, unpaid fees are not considered to be an unusual circumstance; however, impending, threatened, or potential litigation are considered to be unusual circumstances. It is also customary (but not required) for the predecessor accountant to allow access to his or her working papers. However, SSARS No. 4 (AR sec. 400.08) states that valid business reasons (including but not limited to unpaid fees) may lead the predecessor to decide not to allow access to the working papers.

Question—Is an engagement letter required for every compilation engagement or review engagement?

Answer—No. SSARS No. 1 (AR sec. 100.05) states that you should establish an understanding with the client, preferably in writing, regarding the services to be performed in a compilation or review engagement. While an engagement letter is not specifically required, it is advisable to establish the understanding with the client through a written engagement letter. However, if the

engagement is to compile financial statements not expected to be used by a third party (management-use-only compilation), a written communication is required. That communication may be in the form of a compilation report in accordance with the reporting requirements discussed in SSARS No. 1 (AR sec.100.11–.19) or an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. Examples of illustrative engagement letters for compilation and review engagements are included in Appendixes C, D, and E of SSARS No. 1 (AR sec. 100).

Question—A CPA firm is engaged to perform review services and tax preparation for a client. A staff member of the CPA firm resigned his position to take a position with the client. The staff member, however, agreed to return to work at the CPA firm during the tax season to help with corporate and personal tax preparation. Because the staff member has such knowledge of the client, his current full-time employer, he has been assigned to prepare the corporate tax return but does not work on the review engagement. Is the firm independent with respect to the client?

Answer—No. The staff member would be considered a professional employee of the CPA firm since he would provide professional services to the firm’s clients. In accordance with AICPA Interpretation No. 101-1, “Interpretation of Rule 101,” under Rule of Conduct 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.02), the firm’s independence would be impaired since, during the period of the review engagement, a professional employee of the firm would be associated simultaneously with the client as an employee.

Question—A CPA firm is engaged to perform review services for a client. The bookkeeper at the client has taken maternity leave and has asked the CPA firm to provide a staff member to act as the bookkeeper while she is on leave. Will this impair the firm’s independence?

Answer—No. If you take the proper steps when providing these bookkeeping services, the firm’s independence will not be impaired. According to Interpretation No. 101-3, “Performance of Nonattest Services,” under Rule of Conduct 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), the client must agree to perform the following functions in connection with the bookkeeping services:

- Make all management decisions and perform all management functions;
- Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;
- Evaluate the adequacy and results of the services performed;

- Accept responsibility for the results of the services; and
- Establish and maintain internal controls, including monitoring ongoing activities.

You should be satisfied that the client will be able to meet all these criteria and make an informed judgment on the results of the bookkeeping services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, you should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or reperform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the bookkeeping services provided, or is unwilling to perform such functions due to lack of time or desire), the firm's provision of these services would impair independence.

Before performing nonattest services, you should establish and document in writing your understanding with the client (board of directors, audit committee, or management, as appropriate in the circumstances) regarding the following:

- Objectives of the engagement
- Services to be performed
- Client's acceptance of its responsibilities
- Your responsibilities
- Any limitations of the engagement

Question—A CPA no longer in public practice owns a small business. Is it appropriate for the CPA to compile and report on the financial statements of her own company?

Answer—No. Interpretation No. 21 of SSARS No. 1 states if an accountant is not in the practice of public accounting, the issuance of a report under SSARS would be inappropriate. However, the accountant may communicate her relationship to the entity. The following is an example of the type of communication that may be used:

The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by [*name of accountant*], CPA. I have prepared such financial statements in my capacity [*describe capacity, for example, as a director*] of Company X.

Question—Are the documentation requirements different for compilation and review engagements? Are the documentation requirements different for management-use-only compilation and traditional (third-party use) compilations?

Answer—SSARS do not contain any specific documentation requirements for traditional compilation engagements. For management-use-only compilation engagements, the only requirement is to document the understanding with the client through a written engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. The accountant need not obtain such an engagement letter if he or she issues a compilation report in accordance with the reporting requirements discussed in SSARS No. 1 (AR section 100.11–.19). For review engagements, SSARS No. 1 (AR sec. 100.37) states that the documentation of the review engagement should include the following:

- The matters covered in your inquiry procedures.
- The analytical procedures performed.
- The expectations as discussed in SSARS No. 1 (AR sec. 100.29), where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations.
- Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts.
- Any additional procedures performed in response to significant unexpected differences arising from the analytical procedures and the results of such additional procedures.
- Unusual matters that you considered during the performance of the review procedures, including their disposition.
- The management representation letter.

In addition to these required items, documentation of the compilation or review engagement might also include:

- A copy of the engagement letter.
- A working trial balance with supporting schedules.
- Compilation or review program with appropriate notation that procedures required by SSARS were performed.
- Checklists for performing review procedures.
- Memoranda summarizing conclusions with respect to the review of the financial statements or providing information to support footnotes.
- Written memo or communication with predecessor CPA (if applicable).

Keep in mind, too, that you are not precluded from supporting your review report by other means. For example, written documentation from other engagements (such as compilation or consulting engagements) may be used to support your review report. In limited situations, oral explanations may provide support. However, oral explanations should be limited to those situations where you find it necessary to supplement or clarify information contained in the working papers. Oral explanations should not be the principal support for the work performed or the conclusions reached.

Question—How long should compilation and review working papers be retained?

Answer—SSARS do not address the issue of working paper retention. Thus, working paper retention is a matter of firm policy and professional judgment.

QUESTIONS ABOUT COMPILATION ENGAGEMENTS

Question—What kind of legend is required on compiled financial statements?

Answer—If the financial statements are accompanied by a report, each page of the financial statements should include a reference to the report, such as:

“See accountant’s compilation report”

If the financial statements are for management’s use only, each page of the financial statements should include a reference to the restricted nature of the financial statements, such as:

“Restricted for Management’s Use Only,” or

“Solely for the information of and use by the management of XYZ Company and not intended to be and should not be used by any other party.”

Question—A bank has engaged an accountant to compile a balance sheet for another entity. The bank has possession of the books and records of the entity. Can the accountant issue a compilation report under such circumstances?

Answer—SSARS do not preclude you from issuing a compilation report in such a situation. However, SSARS No. 1 (AR sec. 100.08) states that you should possess a general understanding of the nature of the entity’s business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. According to TPA section 9150.18, “Bank Engaged a CPA Firm to Compile a Financial Statement of Another Entity,” due to the nature of the engagement, you may not be able to attain a sufficient understanding of the client’s business as required by SSARS No. 1 to issue a compilation report on the balance sheet.

Question—An accountant prepares a business plan for a client. Included with the business plan are unaudited financial statements. Is a compilation report required for this or any other management consulting services engagement?

Answer—Yes. When financial statements are included with a business plan or any other written findings or recommendations of a management consulting services engagement, and are submitted (prepared and presented) to the client or third parties, SSARS is applicable and you must at least compile and report on the financial statements.

One exception to this general rule is found in Interpretation No. 23, “Applicability of Statements on Standards for Accounting and Review Services When an Accountant Engaged to Perform a Business Valuation Derives Information From an Entity’s Tax Return,” of SSARS No. 1 (AR sec. 9100.89–92). Interpretation No. 23 states that if you derive financial information from an entity’s tax return, and such information is presented as part of the business valuation report, SSARS do not apply. As discussed in SSARS No. 1 (AR sec. 100.04), under the definition of a financial statement, “financial forecasts, projections and similar presentations, and financial presentations included in tax returns are not financial statements for purposes of this Statement” (footnotes omitted). Therefore, according to Interpretation No. 23, even if you have prepared the tax return, you have not prepared financial statements in accordance with SSARS and the financial information derived from the tax return and presented as part of a business valuation is not deemed to be submission of financial statements as contemplated by SSARS No. 1.

When, in the course of performing a business valuation engagement, you derive financial information from the client’s tax return, or another accountant’s audited, reviewed, or compiled financial statements, or client-prepared financial statements, you should refer to the source of the financial information and include an indication in the business valuation report that you have not audited, reviewed, or compiled the financial information and that you assume no responsibility for the information. The following is an example of wording that may be included in the business valuation report that incorporates the requirements of SSARS No. 1 (AR sec. 100.03):

In preparing our business valuation report, we have relied upon historical financial information provided to us by management and derived from [*refer to the appropriate source of the information, such as tax return, audit report issued by another auditor, and so on*]. This financial information has not been audited, reviewed, or compiled by us and accordingly we do not express an opinion or any form of assurance on this financial information.

However, if the accountant submits financial statements in the course of performing a business valuation as defined in paragraph 4 of SSARS No. 1 (AR sec. 100.04), the accountant should, at a minimum, comply with the provisions of SSARS applicable to a compilation engagement.

Question—An accountant is in the process of compiling financial statements for the client. The accountant has completed a substantial portion of the work on the financial statements but is missing certain information and has not yet performed all the required procedures. The accountant has labeled the statements “Working Draft.” Is a compilation report required to be attached to the draft statement and may the client distribute the draft financial statement?

Answer—No. Interpretation No. 17, “Submitting Draft Financial Statements,” of SSARS No. 1 (AR sec. 9100.61–62) states that as long as you intend to submit the financial statements in final form and label each page of the draft financial statements as “Draft,” you are not required to attach a report to the draft financial statements. If the client indicates that he or she plans to distribute the draft financial statements to a bank or other third parties before completion of the

compilation engagement, you should inform the client that the best course of action is to wait until the compilation of the financial statements is completed.

Question—When the client elects to omit substantially all disclosures in compiled financial statements, what is meant by “substantially?”

Answer—The term *substantially* is not defined in SSARS. *Webster’s Dictionary* defines *substantially* as “to a great extent or degree.” Generally, when the client elects to omit substantially all disclosures, in fact, *all* disclosures are omitted. When the client chooses to include one or more disclosures, you must use your professional judgment to determine if substantially all disclosures have been omitted.

Question—A client has requested that the accountant compile financial statements that omit substantially all disclosures even though compiled full disclosure financial statements for the same period have just been prepared. Should the accountant agree to the request?

Answer—It depends on the client’s motivation for making such a request. In many small businesses, the notes contain information about related party transactions and profit sharing. Some clients may not want certain users to see such information such as vendors or suppliers. Using professional judgment, you need to satisfy yourself that the client has a valid business reason for making the request and is not trying to mislead those who might reasonably be expected to use such financial statements. If you determine that a valid business reason exists, you should issue the appropriate compilation report clearly indicating the omission of substantially all disclosures. If no valid reason exists, you should decline the request.

Question—When the client includes more than a few, but not all, required disclosures, can the client label notes to the financial statements “Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included?”

Answer—Interpretation No. 22, “Use of ‘Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included,’ ” of SSARS No. 1 (AR sec. 9100.85–.88), states that when the financial statements include more than a few but not all required disclosures, this approach is *not* appropriate. The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation or review report like any other departure from GAAP; the nature of the departure and its effects, if known, should be disclosed. You should use your judgment in determining the appropriateness of the label.

QUESTIONS ABOUT MANAGEMENT-USE-ONLY COMPILATION ENGAGEMENTS

Question—When an accountant submits financial statements to a nonpublic client that are not expected to be used by a third party, must the accountant issue a compilation report?

Answer—You have two communication options. You may issue a compilation report in accordance with SSARS No. 1 (AR sec. 100). Alternatively, you may document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. Appendix D of SSARS No. 1 contains an illustrative engagement letter when compiling financial statements not intended for third party use.

Question—May an accountant issue a standard compilation report on financial statements that have previously been compiled for management’s use only?

Answer—Yes. However, you would have to comply with the reporting requirements in SSARS No. 1 (AR sec. 100.11–.19) before issuing the compilation report.

Question—May an accountant compile interim financial statements (for example, monthly or quarterly) that are restricted to management’s use only and then issue a standard compilation report on the year-end financial statements?

Answer—Yes. However, the compilation of the year-end financial statements would be considered a separate engagement and would be subject to both the performance standards and reporting standards in SSARS No. 1 (AR sec. 100).

Question—What should an accountant do if he or she discovers that financial statements that were restricted to management’s use only have been distributed to third-parties?

Answer—The first step should be to discuss the situation with the client and remind him or her of the restricted nature of the financial statements. You should also request that the client retrieve any copies of the financial statements that have been distributed to third-parties. If the client complies with this request, no further action is necessary.

If the client does not comply with this request within a reasonable period of time, you should attempt to notify known third-parties that the financial statements are not intended for third party use. Since this action will involve complex legal issues, you should consider consulting with an attorney before proceeding.

Question—May an accountant issue a standard compilation report on comparative statements when the prior period financial statements were restricted to management’s use only?

Answer—Yes. However, you will have to comply with the SSARS No. 1 (AR sec. 100) reporting requirements for both periods before issuing the report on the comparative statements. In other words, the reporting requirements in SSARS No. 1 (AR sec. 100.11–.19) would apply to both periods.

Question—May an accountant include supplementary information with management-use-only financial statements?

Answer—Yes. You may include supplementary information, which may include charts, graphs, tables, or details of financial statement line items with the financial statements. If you decided to issue a compilation report in accordance with SSARS No. 1, you should refer to the other data in the compilation report or issue a separate report on the other data. If you decided to document an understanding with the entity through the use of an engagement letter, you should include a statement in the engagement letter indicating your level of responsibility with respect to the supplementary information, such as:

The other data accompanying the financial statements are presented only for supplementary analysis purposes and were compiled from information that is the representation of management, without audit or review, and we do not express an opinion or any other form of assurance on such data.

Question—Is it possible for someone who is a third party to become a non-third party?

Answer—Yes, as long as that party is a member of management. To not be considered a third party, the person must meet two tests:

1. He or she is a member of management.
2. He or she is knowledgeable enough about the business to put the information in the proper context.

If the person is not generally knowledgeable about and does not understand the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements, he or she can be educated and “brought into the loop.” This education can be done by other members of management or by the accountant.

Question—What titles should be used on financial statements restricted to management’s use only?

Answer—In general, titles such as “Income Statement” or “Balance Sheet” should only be used on GAAP financial statements. Appropriate titles for OCBOA financial statements include “Statement of Assets, Liabilities, and Equity—Income Tax Basis” or “Statement of Revenues and Expenses—Cash Basis.” However, as a result of the restricted nature of these financial statements, strict adherence to proper titles is not always necessary. Since these financial statements are designed to meet management’s needs in managing their business, you can use titles based on management preference, as long as those titles are not misleading.

QUESTIONS ABOUT PRESCRIBED FORMS

Question—A client has devised a financial statement presentation form that is not in conformity with GAAP. May an accountant prepare compiled financial statements per the client’s presentation as a prescribed form?

Answer—No. According to SSARS No. 3 (AR sec. 300.02), a form designed by the client is not considered to be a prescribed form.

Question—Can an accountant compile financial statements in a prescribed form if he or she has audited, reviewed, or compiled financial statements for the same period? Should the accountant’s compilation report on the prescribed form refer to the report on the previous service?

Answer—You can compile financial statements in a prescribed form if you have previously audited, reviewed, or compiled financial statements for the same period. If the measurement principles used in the compiled financial statements in the prescribed form cause such financial statements to be materially different from the previously audited, reviewed, or compiled financial statements, no reference should be made to the report on the previous service.

Question—Can an accountant attach a prescribed form to compiled or reviewed financial statements as supplementary information?

Answer—Yes. Supplementary information is defined in SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551.03) as information outside the basic financial statements and not considered necessary for presentation of financial position, results of operations, or cash flows in accordance with GAAP. Such information includes:

- Additional details or explanations of items in or related to the basic financial statements
- Consolidating information
- Historical summaries of items extracted from basic financial statements
- Statistical data
- Other material, some of which may be from sources outside the accounting system or outside the entity

Therefore, you may attach a prescribed form to compiled or reviewed financial statements as supplementary information, as long as you clearly indicate the degree of responsibility you are taking for the supplementary information.

Question—Is an accountant precluded from attaching compiled, reviewed, or audited financial statements to a prescribed form?

Answer—No. There is nothing in SSARS that precludes you from attaching compiled, reviewed, or audited financial statements to a prescribed form.

Question—An accountant attaches a schedule of officers' compensation as supplementary information to a prescribed form. Must the accountant indicate his or her responsibility he or she assumes for the additional information?

Answer—Yes. SSARS No. 1 (AR sec. 100.49) requires that you clearly indicate the degree of responsibility, if any, you are taking with respect to the supplementary information. If the financial statements included in the prescribed form are compiled, the compilation report should refer to the other data or you can issue a separate report on the supplementary information.

Question—Does an accountant have to be independent to compile a financial statement in a prescribed form?

Answer—No. However, you would need to include the following as the last paragraph in the compilation report on the prescribed form: "I am (we are) not independent with respect to XYZ Company."

Question—Does each page of the prescribed form need to be marked "See Accountant's Compilation Report?"

Answer—Yes. Each page of the prescribed form should include a reference to the compilation report.

Question—Should the accountant sign the preprinted report form or issue a separate report in accordance with SSARS No. 3?

Answer—SSARS No. 3 (AR sec. 300.05) states that you should not sign a preprinted report form unless it complies with the standard report in SSARS No. 1 (AR sec. 100) or SSARS No. 3 (AR sec. 300). Instead, you should attach the appropriate report to the prescribed form.

Question—A prescribed form is in an electronic format. However, the electronic input does not allow for the accountant to include a compilation report. Is the accountant required to send a compilation report?

Answer—Yes. To comply with SSARS No. 3 (AR sec. 300) you should append an appropriate report to the prescribed form. The report could be sent electronically or manually.

Question—A prescribed form requires that property, plant, and equipment be presented at market value rather than at depreciated cost. Should this GAAP departure be identified in the accountant's report? Can the accountant alter the prescribed form?

Answer—The departure does not have to be identified in the report. In addition, you should not alter the prescribed form. SSARS No. 3 (AR sec. 300.03) states that there is a presumption that the information required by a prescribed form is sufficient to meet the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from GAAP required by the prescribed form or related instructions. On the other hand, if there is a departure from GAAP, other than departures that may be called for by the prescribed form or related instructions, you should follow the guidance in SSARS No. 1 (AR sec. 100.45–.47). If you become aware of a departure from the requirements of the prescribed form or related instructions, you should consider that departure as the equivalent of a GAAP departure in determining the effect on your report.

Question—A client has requested an accountant compile the financial statements included in a prescribed form. The prescribed form does not specify the basis of accounting to be used in completing the form. What basis of accounting should be used?

Answer—If the prescribed form or related instructions do not specify the basis of accounting to be used, the presumption is that GAAP should be used. However, departures from GAAP required by the prescribed form or related instructions would not have to be identified in the report.

Question—A client prepares its financial statements in accordance with GAAP. The client has requested the accountant compile its financial statements included in a prescribed form. The prescribed form does not specify the basis of accounting to be used in completing the form; however, the client requests that the accountant use the modified cash basis of accounting. Is there anything precluding the accountant from honoring the client’s request?

Answer—There is nothing in SSARS that would preclude you from honoring the client’s request.

QUESTIONS ABOUT REVIEW ENGAGEMENTS

Question—Are management representation letters required for review or compilation engagements?

Answer—SSARS No. 1 (AR sec. 100.32–.33) requires that, in a review engagement, you obtain a representation letter from members of management whom you believe are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter. A management representation letter is not required in a compilation engagement. (However, the AICPA Audit and Accounting Guide *Personal Financial Statements Guide* recommends that practitioners obtain a representation letter in all personal financial statement engagements, even in a compilation.)

Question—As part of a review engagement, the accountant has requested a management representation letter from management. The current management was not present during all periods covered by the review report and will not furnish the management representation letter. What options does the accountant have?

Answer—SSARS No. 1 (AR sec. 100.32–.33) requires that, in a review engagement, you obtain a representation letter from members of management whom you believe are responsible for and knowledgeable about the matters covered in the representation letter. The letter should be signed by those members of management who you believe are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter. If current management was not present during all periods covered by your report, you should nevertheless obtain written representations from current management on all such periods. SSARS No. 1 (AR sec. 100.53) states that if, in a review engagement, a client does not provide you with a signed representation letter, you are precluded from issuing a review report on the financial statements and would ordinarily be precluded from issuing a compilation report on the financial statements. Thus, you would not be able to step down to a compilation engagement.

Question—If a client refuses to provide a representation letter in a review engagement, can the accountant issue a compilation report?

Answer—No. SSARS No. 1 (AR sec. 100.32) states that written representations are required from management for all financial statements and periods covered by the accountant’s review report. In addition, SSARS No. 1 (AR sec. 100.53) states that if, in a review engagement, a client does not provide you with a signed representation letter, you would also ordinarily be precluded from issuing a compilation report on the financial statements. Thus, you would not be able to step down to a compilation engagement.

Question—An accountant has prepared comparative reviewed financial statements. Should the management representation letter cover both periods shown in the reviewed financial statements?

Answer—Yes. The representations obtained at the completion of the most recent review should address all periods covered by the report, according to SSARS No. 1 (AR sec. 100.32).

Question—What are the differences between analytical procedures performed for an audit and for a review engagement?

Answer—There is a subtle difference between analytical procedures performed for an audit engagement and a review engagement. This difference is based on the desired level of assurance. In an audit, the analytical procedures are designed to provide reasonable assurance that the financial statements are fairly presented. In a review, they are performed in connection with inquiries of management to provide limited assurance that you are not aware of any material modifications that should be made to the financial statements.

The main difference between analytical procedures performed for an audit engagement and those performed in a review engagement are that the expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.

Question—If the accountant performs additional procedures, such as confirmation of receivables and observation of inventories in connection with a review engagement, does he or she have to change the engagement to an audit?

Answer—No. According to Interpretation No. 13, “Additional Procedures,” of SSARS No. 1 (AR sec. 9100.46–49), SSARS makes it clear that the standards for performing compilations or reviews of financial statements do not preclude you from performing any procedures that you deem necessary or that the client requests. However, you should have a clear understanding with the client regarding the services to be performed (preferably in writing), including a description

of the report you expect to render. When you, in connection with a compilation or review engagement, plan to perform procedures that are customarily applied during an audit, you may wish to place additional importance on whether the understanding with the client should be in writing.

Question—If the accountant performs other services for the client (for example, bookkeeping, payroll, or income tax), may he or she use the information obtained from these services to reduce the amount of inquiries and analytical procedures in a review of the clients financial statements?

Answer—Yes. You may obtain information from a variety of accounting services. SSARS No. 1 (AR sec. 100.34) states that knowledge acquired in the performance of audits of the client’s financial statements, compilation of the financial statements, or other accounting services may result in modification of the inquiries and analytical procedures. However, you should ensure that the documentation in the other engagement files and the review engagement files are adequate to support the procedures performed and the conclusions reached.

Question—Is there a minimum level of information needed in a review engagement?

Answer—This is strictly a matter of professional judgment. Most accountants have a standard set of inquiries and analytical procedures that are a starting point for every engagement. This standard set is modified based on economic, industry, and client characteristics. The engagement is complete when you have obtained a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements.

Question—An accountant is in the process of reviewing financial statements and has requested a management representation letter from the client. The client, due to its limited knowledge of accounting principles, is uncomfortable to make such representations. What should be done?

Answer—A recent AICPA *Compilation and Review* Audit Risk Alert contains the following illustrative modification to the standard management representation letter that might make these clients feel more comfortable:

The financial statements referred to above present fairly the financial position, results of operations, and cash flows of [name of client] in conformity with GAAP. However, because of our limited expertise with GAAP, including financial statement disclosure, we have engaged you to advise us in fulfilling that responsibility. In connection with the review of the aforementioned financial statements we specifically confirm that. . .

Question—Can an accountant review financial statements that omit substantially all disclosures?

Answer—No. According to Interpretation No. 1, “Omission of Disclosures in Reviewed Financial Statements,” of SSARS No. 1 (AR sec. 9100.01–.02), only financial statements that you have compiled may omit substantially all disclosures. Because of the reporting requirements of SSARS No. 1, you would not accept an engagement to review financial statements that omit substantially all of the disclosures required by GAAP. When you have undertaken a review of financial statements and subsequently find that your client declines to include all required disclosures, your review report should include the disclosures omitted from the financial statements. However, if the information required to be disclosed has not been determined by management or is not known as a result of your procedures, you are not required to determine the specific information that should be disclosed. In that case, your review report should specifically identify the nature of the omitted disclosures.

QUESTIONS ABOUT REPORTING ON COMPILED OR REVIEWED FINANCIAL STATEMENTS

Question—Does the accountant have to identify each and every measurement departure from GAAP or OCBOA?

Answer—If the financial statements are accompanied by a report, each known departure that would have a material effect on the financial statements must be either corrected or disclosed, along with the effect of the departure on the financial statements (if the effect is known). If the accountant believes that modification of the standard report is not adequate to disclose the deficiencies in the financial statements taken as a whole, he or she should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements.

If the compiled financial statements are for management's use only and the accountant does not issue a compilation report in accordance with the reporting requirements of SSARS No. 1, a statement can be made in the engagement letter that "material departures from GAAP or OCBOA may exist and the effects of these departures, if any, on the financial statements may not be disclosed."

Question—Can the accountant make a statement that the financial statements are "not presented in conformity with GAAP or an other comprehensive basis of accounting (OCBOA)"?

Answer—No. Including such a statement in a compilation report would be tantamount to expressing an adverse opinion on the financial statements taken as a whole, according to Interpretation No. 7 of SSARS No. 1 (AR sec. 9100.23–.26). Such an opinion can be expressed only in the context of an audit engagement.

If the financial statements are accompanied by a report, each known departure that would have a material effect on the financial statements must be either corrected or disclosed, along with the effect of the departure on the financial statements (if the effect is known). If the accountant believes that modification of the standard report is not adequate to disclose the deficiencies in the financial statements taken as a whole, he or she should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements.

Question—A consulting firm has a nonprofit organization as a client. The consulting firm, which does not perform accounting services, has engaged a CPA to compile the financial statements of the nonprofit organization. Can the CPA compile the financial statements because he or she was

engaged by the consulting firm and not the nonprofit organization? And to whom should the report be addressed, the consulting firm or the nonprofit organization?

Answer—SSARS do not preclude you from compiling the financial statements and issuing a compilation report in such a situation. However, SSARS No. 1 (AR sec. 100.08) states that you should possess a general understanding of the nature of the entity’s business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. According to TPA section 9150.18, “Bank Engaged a CPA Firm to Compile a Financial Statement of Another Entity,” due to the nature of this engagement, you may not be able to attain a sufficient understanding of the not-for-profit organization as required by SSARS No. 1. If you decide that you are able to attain a sufficient understanding of the organization, the compilation report should be addressed to the consulting firm, which is the engaging entity.

Question—An accountant is engaged to review a client’s financial statements. The review was completed and the financial statements were distributed. Shortly thereafter, the controller contacts the accountant and indicates that a material accrual that would affect the financial statements was omitted and that the financial statements should be revised. Should the new report mention that the statements are revised? What date should be used on the report on the revised statements?

Answer—SSARS do not address this issue, but the accountant may wish to consider the guidance contained in the auditing standards established by SAS No. 1 *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 561, “Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report”), as amended. The reasons for the revision usually should be described in a note to the financial statements and referred to in the auditor’s report. If the client does not make the appropriate adjustment or disclosure, the accountant should take steps to prevent further reliance on the previously issued report.

When the financial statements are appropriately modified, you should date the review report as of the date of the completion of your review procedures on the revised financial statements.

Question—Should an accountant modify his or her compilation or review report because of a change in accounting principle?

Answer—The manner of accounting for and disclosing a change in accounting principles depends on the nature of the change as described in APB Opinion No. 20, *Accounting Changes*.

Accounting changes might require (1) a cumulative adjustment (for example, a change from first-in, first-out (FIFO) to last-in, first-out (LIFO)), (2) a restatement of prior financial statements (for example, a change from LIFO to FIFO), or (3) neither a cumulative effects adjustment nor a restatement of the prior year's financial statements (for example, a consistent policy of changing from an accelerated method to the straight-line method at a specified point in the life of an asset to maximize depreciation). However, all accounting changes that result in a cumulative adjustment or a restatement must be adequately disclosed in the current year's financial statements.

SSARS does not require modification of your standard compilation or review report if the accounting change is properly accounted for and disclosed in the financial statements. Nonetheless, you may emphasize in a separate paragraph that an accounting change has occurred.

Question—A client who was formerly a sole proprietorship incorporates. Is this considered a change in reporting entity and should the compilation or review report be modified?

Answer—APB Opinion No. 20 states that in a change in reporting entity, a different group of companies comprise the reporting entity after the change. This type of accounting change is limited mainly to (1) presenting consolidated or combined statements in place of statements of individual companies, (2) changing specific subsidiaries comprising the group of companies for which consolidated financial statements are presented, and (3) changing the companies included in combined financial statements. Therefore, changing from a sole proprietorship to a corporation is not a change in reporting entity. SSARS do not require modification of your standard compilation or review report in this case. Nonetheless, you may emphasize in a separate paragraph that an accounting change has occurred.

Question—An accountant compiled tax basis financial statements for a charitable remainder trust. The trustee has asked the accountant to include in the section of the report that says “a compilation is limited to presenting in the form of financial statements information that is the representation of the Trustee . . .” an additional sentence that would state “The financial statements are based on information provided by the client, which includes, in relevant part, monthly statements from the investment custodian.” Is it permissible to add this language to the compilation report?

Answer—SSARS do not preclude you from modifying the language in the standard compilation report.

Question—An accounting firm was engaged to review financial statements. Due to a scope limitation, the accountant is requested to change the engagement to a compilation. Should the accountant mention the scope limitation in the compilation report?

Answer—No. If you conclude, based on your professional judgment, that there is a reasonable justification to change the engagement and if you comply with the standards for the compilation engagement, you may issue the compilation report. The report should not include reference to (1) the original engagement, (2) any review procedures that may have been performed, or (3) the scope limitation that resulted in the changed engagement.

Question—An entity may wish to engage an accountant to report on compiled financial statements each month and to review the financial statements of the entity at year end. May an accountant issue a compilation report on the monthly financial statements and a review report on annual financial statements for a period ending on the same date as one of the monthly financial statements?

Answer—Yes. According to Interpretation No. 3, “Reporting on the Highest Level of Service,” of SSARS No. 1 (AR sec. 9100.09–.10), you may issue a compilation report on the monthly financial statements and a review report on the annual financial statements for a period ending on the same date, provided you comply with the applicable standards for each engagement.

Question—An accountant has been engaged to compile financial statements of an entity. During the course of the engagement the accountant applies analytical procedures and makes inquiries. Is the accountant required to issue a review report? If an accountant is engaged to compile or review financial statements and during the course of that engagement performs certain procedures, such as confirmation of receivables and observations of inventory, which are normally performed in an audit, is he or she required to change the engagement to an audit?

Answer—No. SSARS provides the minimum level of procedures that an accountant must perform to provide no assurance (compilation) or limited assurance (review) that the financial statements do not require any material modifications to be in conformity with GAAP. The accountant may perform any additional procedures that he or she considers necessary to provide the appropriate level of assurance.

Question—Can an accountant issue an audit report on the balance sheet and a review report on the income statement for the same year?

Answer—No. SSARS No. 1 (AR sec. 100.02) states if the accountant performs more than one service, the accountant should issue the report that is appropriate for the highest level of service rendered. If the accountant has audited the balance sheet but not the income statement or the statement of cash flows, he or she should adhere to the reporting requirements contained in the auditing literature.

Question—An accountant is compiling comparative financial statements for a corporation. In year 20X1, its financial statements were prepared on the GAAP basis. In 20X2, the statements will be prepared on an income tax basis. How will the compilation report be modified to reflect the change in presentation?

Answer—Compiled financial statements prepared in accordance with GAAP are not comparable to those prepared in accordance with a comprehensive basis of accounting other than GAAP (such as the income tax basis). Accordingly, the accountant should not issue a report on comparative financial statements if the client does not restate the prior year(s) financial statements. However, when only current year financial statements are presented, a change from GAAP to OCBOA (or vice versa) does not represent a change in accounting principles as described in APB Opinion No. 20, *Accounting Changes*. Therefore, no justification for the change is required and no cumulative adjustment is necessary. It is common practice to present the effect of the change in the accounting basis by showing beginning retained earnings as previously reported with an adjustment to convert to the new basis. Although not as common in practice, precedent also exists for either showing opening retained earnings on the new basis or showing the effects of the change as a cumulative-effect adjustment in the income statement.

SSARS does not require you to modify a compilation or review report if the financial statements appropriately disclose the change. However, you are not precluded from emphasizing the change in a separate paragraph of the report.

Question—An accountant has been asked to compile financial statements for the 12 months ended March 31, 20X7. However, the entity's year end for income tax reporting is December 31, 20X7. Should the compilation report be modified?

Answer—There is no requirement in the accounting literature for the tax and the financial reporting year end to be the same. However, having different fiscal years complicates further any interperiod tax allocation the entity may have. There is no requirement to modify the compilation report, provided the title of the financial statements is descriptive of the period covered and the compilation report clearly indicates the period covered by the financial statements. However, you are not precluded from emphasizing the matter in a separate paragraph of the report.

Question—In 20X1, an accountant compiled and reported on full disclosure financial statements. In 20X2, the client has decided to omit all disclosures. May the financial statements be shown comparatively?

Answer—No. SSARS No. 2 (AR sec. 200.05) states that compiled financial statements that omit substantially all of the disclosures required by GAAP are not comparable to financial statements that include such disclosures. Accordingly, the accountant should not issue a report on comparative financial statements when statements for one or more, but not all, of the periods presented omit substantially all of the disclosures required by GAAP.

However, the accountant may compile the 20X1 financial statements that do omit substantially all disclosures. In this way, the 20X1 and 20X2 financial statements are comparable and may be reported on as such. According to SSARS No. 2 (AR sec. 200.29), in this circumstance, you may report on the comparative compiled financial statements if you include in your compilation report an additional paragraph indicating the nature of the previous service rendered with respect to those financial statements and the date of your previous report. An example of this additional paragraph is as follows:

The accompanying 20X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all the disclosures required by generally accepted accounting principles and that I (we) previously compiled as indicated in my (our) report dated March 1, 20X2.

Question—When there has been a change in accountants, is it appropriate to mention the name of the prior accountant in the report when reporting on comparative financial statements?

Answer—No. According to footnote 9 of SSARS No. 2 (AR sec. 200.17), you should not name the predecessor accountant in your report. However, you may name the predecessor accountant if you acquired or merged with the predecessor accountant's firm.

Question—If the accountant agrees to compile financial statements that omit substantially all disclosures even though compiled full disclosure financial statements have just been prepared, should the accountant make reference to the full disclosure financial statements in the compilation report?

Answer—You may report on compiled financial statements that omit substantially all disclosures in accordance with SSARS No. 1 (AR sec. 100.16–.18), provided the omission is not, to your knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. No reference should be made to the full disclosure financial statements.

Question—A client has requested that the accountant compile financial statements that omit substantially all disclosures required by GAAP. During the course of the engagement, a going concern issue arises. Is it still appropriate to issue financial statements that omit substantially all disclosures?

Answer—Yes. Since the financial statement user is alerted that substantially all disclosures have been omitted from the financial statements (by adding a paragraph to the compilation report to explain the omission), going concern disclosures would not be required.

Although not required, the going concern matter can be disclosed. In this case however, the disclosure should be made in the financial statements. Keep in mind that emphasis paragraphs should not introduce new information about the financial statements. If the going concern is the only disclosure included in the financial statements, it should be labeled as “Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included.” Once disclosed in the financial statements, you may emphasize the matter in a separate paragraph of your report.

Question—A client prepares full disclosure statements and omits a required disclosure about a going concern issue. Should the accountant modify his or her report?

Answer—Footnote 23 of SSARS No. 1 (AR sec. 100.46) states that “normally, neither an uncertainty, including an uncertainty about an entity’s ability to continue as a going concern . . . would cause the accountant to modify the standard report *provided the financial statements appropriately disclose such matters.*” (Emphasis added.) Since the appropriate disclosure about going concern has been omitted, you should modify your compilation or review report to identify this GAAP departure (the missing disclosure).

Question—If an entity does have a component of comprehensive income and displays the comprehensive income in conformity with GAAP, does the wording of the introductory paragraph of the compilation or review report need to be modified?

Answer—The accountant should reference the individual financial statements as titled by the client. If comprehensive income is reported in the income statement, the client should modify the title of the statement (for example, “Statement of Income and Comprehensive Income”).

Question—Can the display of comprehensive income be omitted when issuing a compilation report?

Answer—Yes. Interpretation No. 25 of SSARS No. 1 (AR sec. 9100.95–.99) clarifies that when an element of comprehensive income is present, the display of comprehensive income may be omitted when issuing a compilation report with substantially all disclosures omitted. The Interpretation notes that FASB Statement No. 130 requires the display of comprehensive income when a full set of financial statements is presented in conformity with GAAP. However, the display of comprehensive income can be omitted by identifying the omission in the compilation report or engagement letter (when the compiled financial statements are not expected to be used by a third party).

If the accountant compiles financial statements that include all disclosures but omit the display of comprehensive income, the omission should be treated as a departure from GAAP. Additionally, if an element of comprehensive income has not been computed, for example, unrealized gains and losses arising from investments in marketable securities classified as “available for sale,” the accountant should consider a departure from GAAP and follow the guidance in SSARS No. 1 (AR sec. 100.45–.47).

Question—What date should be used on a report for reviewed financial statements or compiled financial statements?

Answer—For both compilations and reviews, the date of completion of the appropriate procedures should be used as the date of the accountant’s report.

Question—When an accountant updates a previously issued report for purposes of reporting on comparative statements, what date should be used on the report?

Answer—An updated report takes into consideration information that you become aware of during your current engagement and re-expresses your previous conclusions or expresses different conclusions on the prior-period financial statements as of the date of your current report. Therefore, you should use the date of completion of the current engagement for the report.

Question—When prior period financial statements have been revised, what date should be on the report?

Answer—According to SSARS No. 2 (AR sec. 200.07), the accountant should report on the financial statements as restated. As such, the accountant should report on the financial statements in accordance with the compilation or review standards in SSARS No. 1, including the requirements regarding dating the report.

Question—Is an accountant precluded from issuing a compilation or review report on a single financial statement, for example, an income statement?

Answer—No. According to SSARS No. 1 (AR sec. 100.15 and 100.43), you may issue a compilation report on a single financial statement and may issue a review report in a single financial statement as long as the scope of your inquiry and analytical procedures have not been restricted.

Question—A corporation owns multiple restaurants. Is it permissible to compile financial statements for one of the restaurants?

Answer—Yes. SSARS No. 1 (AR sec. 100.04) states that a financial statement may be that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, a segment of any of these, or an individual.

Question—Should the accountant refer to the country of origin of engagement standards and/or accounting principles in compilation or review reports?

Answer—According to Interpretation No. 24, “Reference to the Country of Origin in a Review or Compilation Report,” of SSARS No. 1 (AR sec. 9100.93–.94), you are not required to refer to the country of origin in these reports since the reports refer to the American Institute of Certified Public Accountants. However, there is nothing to preclude you from making the reference if you believe that it is appropriate under the circumstances to include it in the report.

Question—Do compilation and review reports require a signature?

Answer—Yes. According to SSARS No. 1 (AR sec. 100.11 and 100.38), the signature of the accountant or firm may be manual, electronic, stamped, or typed.

Question—A client is involved in a lawsuit, the outcome of which will be determined at a later date. Must the accountant include an explanatory paragraph in a compilation or review report?

Answer—No. According to footnote 23 of SSARS No. 1 (AR sec. 100.46), if the financial statements appropriately disclose the uncertainty, you do not have to include an explanatory paragraph to the report. However, SSARS do not preclude you from emphasizing the matter in a separate paragraph of the report.

Question—An accountant has audited the financial statements of a C corporation prepared in accordance with GAAP of the United States of America. Another accounting firm has audited the financial statements of a Hong Kong partnership. The audited financial statements of the Hong Kong partnership were not prepared in accordance with GAAP of the United States of America. The client has requested a compilation report on the combined U.S. GAAP C corporation statements and the Hong Kong GAAP (non-U.S. GAAP) financial statements for the previously issued audited financial statements. In general, can a compilation report be issued on previously audited financial statements? Can financial statements prepared on U.S. GAAP be combined with financial statements not prepared on U.S. GAAP?

Answer—With respect to the first part of the question, an accountant may compile consolidated financial statements when the financial statements of one or more of the component entities were audited as the consolidated financial statements themselves were not audited. However, in this case, the financial statements prepared under two separate basis of accounting cannot be combined.

Question—When an accountant is engaged to perform a business valuation of an entity, it may be necessary for the accountant to derive financial information to be used in that business valuation from the client’s tax return. This is particularly true if the entity does not have audited, reviewed, or compiled financial statements. If an accountant derives financial information from an entity’s tax return, and such information is presented as part of the business valuation report, do SSARS apply?

Answer—No. As discussed in SSARS No. 1 (AR sec. 100.04), under the definition of a financial statement, “financial forecasts, projections and similar presentations, and financial presentations included in tax returns are not financial statements for purposes of this Statement.” Therefore, even if you have prepared the tax return, you have not prepared financial statements in accordance with SSARS and the financial information derived from the tax return and presented as part of a business valuation is not deemed to be submission of financial statements as contemplated by SSARS No. 1, according to Interpretation No. 23 of SSARS No. 1 (AR sec. 9100.89–.92).

When, in the course of performing a business valuation engagement, you derive financial information from the client’s tax return, or another accountant’s audited, reviewed, or compiled financial statements, or client-prepared financial statements, you should refer to the source of the financial information and include an indication in the business valuation report that you have not audited, reviewed, or compiled the financial information and that you assume no responsibility for the information. The following is an example of wording that may be included in the business valuation report that incorporates the requirements of SSARS No. 1 (AR sec. 100.03):

In preparing our business valuation report, we have relied upon historical financial information provided to us by management and derived from [*refer to the appropriate source of the information, such as tax return, audit report issued by another auditor, and so on*]. This financial information has not been audited, reviewed, or compiled by us and accordingly we do not express an opinion or any form of assurance on this financial information.

However, if you submit financial statements in the course of performing a business valuation as defined in SSARS No. 1 (AR sec. 100.04), then, at a minimum, you should comply with the provisions of SSARS applicable to a compilation engagement.

Question—An accountant compiles financial statements for a client. The company suspects that the inventory is inflated and has asked the accountant to observe the physical inventory and apply additional analytical procedures to the inventory only. The client has asked the accountant to detail the procedures in the compilation report and to report that the inventory is fairly stated. May the accountant agree to this request?

Answer—No. Although you may perform additional procedures in a compilation, such as observing the physical inventory and applying analytical procedures, SSARS No. 1 (AR sec. 100.11) states that any additional procedures you perform before or during the compilation should not be described in the report.

However, you may enter into an agreed-upon procedures engagement with the client (as a compilation engagement provides no assurance with respect to the financial statements). If you are engaged to perform an agreed-upon procedures engagement, you must follow the guidance contained in the Attestation Standards.

QUESTIONS ABOUT SUPPLEMENTARY INFORMATION

Question—What types of information should be considered supplementary information?

Answer—The term *supplementary information* is not defined in SSARS. SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AU sec. 551.03), defines this type of information as information that is presented outside of the basic financial statements and is not considered necessary for presentation of financial position, results of operations, or cash flows in conformity with GAAP. Such information includes:

- Additional details or explanations of items in or related to the basic financial statements
- Consolidating information
- Historical summaries of items extracted from basic financial statements
- Statistical data
- Other material, some of which may be from sources outside the accounting system or outside the entity

Question—Does a chart or stand-alone graphic that is presented alone constitute a financial statement? Are charts and graphs considered supplementary information?

Answer—Charts and graphs do not constitute a financial statement. SSARS No. 1 (AR sec. 100.04) defines a financial statement as “a presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with GAAP or OCBOA.” Charts and graphs may be considered supplementary information, however. The term *supplementary information* is not defined in SSARS. SAS No. 29 (AU sec. 551.03) defines this type of information as information that is presented outside of the basic financial statements and is not considered necessary for presentation of financial position, results of operations, or cash flows in conformity with GAAP. Such information includes:

- Additional details or explanations of items in or related to the basic financial statements
- Consolidating information
- Historical summaries of items extracted from basic financial statements
- Statistical data

- Other material, some of which may be from sources outside the accounting system or outside the entity

SSARS No. 1 (AR sec. 100.49) requires that you indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements. If charts and graphs are presented as supplementary information, they should include a reference to the report such as “See Accountant’s Compilation (or Review) Report.”

Question—What should be done if a client insists that a schedule that provides detail of a line item in a basic financial statement be included as part of the basic financial statement?

Answer—SAS No. 29 (AU sec. 551.02) states that the following presentations are considered part of the basic financial statements: descriptions of accounting policies, notes to financial statements, and schedules and explanatory material that are identified as being part of the basic financial statements. Therefore, if the client wishes to include detail of a financial statement line item as part of the basic financial statements, this information would not be considered supplementary information.

Question—When an accountant reviews financial statements that are accompanied by supplementary information, should the supplementary information be reviewed or compiled?

Answer—SSARS No. 1 (AR sec. 100.49) requires that you should indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements.

If the basic financial statements are reviewed, the degree of responsibility you are taking is indicated either in the review report on the basic financial statements or in a separate report on the other data. Specifically, the explanation should state that the review was made primarily for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with GAAP, and, according to SSARS No. 1 (AR sec. 100.49), either:

- The other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the financial statements, and you did not become aware of any material modifications that should be made to such data, or
- The other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the financial statements, but were compiled from information that is the repre-

sentation of management, without audit or review, and you do not express an opinion or any other form of assurance on such data. (In other words, you are stating that you reviewed the financial statements but only *compiled* the supplementary information.)

In any case, the important thing to remember is to clearly indicate the degree of responsibility you are taking for any information accompanying the basic financial statements.

Question—Must the accountant also compile supplementary information that accompanies compiled financial statements?

Answer—As noted in the previous question, SSARS No. 1 (AR sec. 100.49) requires that you should indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements.

If the basic financial statements are compiled, the compilation report should be modified or you can issue a separate report on the supplementary information. The report may be modified as follows:

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, and the accompanying supplementary information contained in Schedules A and B, which are presented only for supplementary analysis purposes, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. I (We) have not audited or reviewed the accompanying financial statements or supplementary information and, accordingly, do not express an opinion or any other form of assurance on them.

If a separate report on the supplementary information is issued, it may read as follows:

I (We) have compiled the accompanying supplementary information contained in Schedules A and B, which are presented only for supplementary analysis purposes.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. I (We) have not audited or reviewed the accompanying supplementary schedules and, accordingly, do not express an opinion or any other form of assurance on them.

If the basic financial statements are compiled for management's use only, the engagement letter should include the following language:

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and I (we) will not express an opinion or any other form of assurance on such data.

Question—What is the accountant’s responsibility if the client wants to attach client-prepared supplementary information to the financial statements that the accountant has compiled or reviewed?

Answer—Although you do not have a responsibility to compile or review the client-prepared information, SSARS No. 1 (AR sec. 100.49) states that you should indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements. When you have reviewed the basic financial statements, an explanation should be included in the review report, or in a separate report on the other data.

Question—Can financial forecasts or projections be considered supplementary information?

Answer—Yes. However since SSARS No. 1 states that financial forecasts, projections, and similar presentations, and financial presentations included in tax returns are not financial statements, the accountant is precluded from compiling or reviewing such information under SSARS. SSARS No. 1 (AR sec. 100.49) requires that you indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements. If forecasts or projections are presented as supplementary information, they should include a reference to the report.

If the client engages the accountant to report on such information, Chapter 3, “Financial Forecasts and Projections,” of SSAE No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 301), as amended, sets forth the standards for engagements related to prospective financial statements. Chapter 3 of SSAE No. 10 (AT sec. 301) states that you should perform an examination, compilation (not a SSARS compilation, however), or agreed-upon procedures engagement, whenever you:

- Submit to your client or others prospective financial statements that you have assembled or assisted in assembling that are or reasonably might be expected to be used by another (third) party; or
- Report on prospective financial statements that are or reasonably might be expected to be used by another (third) party.

QUESTIONS ABOUT FRAUD AND ILLEGAL ACTS

Question—What is an accountant’s responsibility concerning fraud on compilation and review engagements?

Answer—SSARS No. 1 (AR sec. 100.05) states that the accountant should establish an understanding with the entity that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and that the accountant will inform the appropriate level of management of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless clearly inconsequential. However, in a review engagement, the accountant should consider inquiring to members of management who have responsibility for financial and accounting matters concerning their knowledge of any fraud or suspected fraud affecting the entity involving senior management or others where the fraud could have a material effect on the financial statements, for example, communications received from employees, former employees, or others. In addition, in connection with a review of financial statements presented in accordance with GAAP, specific written representations are required from management for all financial statements and periods covered by the accountant’s report regarding:

- Management’s acknowledgement of its responsibility to prevent and detect fraud
- Knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others

Question—If, during the performance of a compilation or review engagement, the accountant suspects that fraud or an illegal act may have occurred, does the accountant need to perform additional procedures to ascertain whether the fraud or illegal act, in fact, occurred?

Answer—No, you need not perform additional procedures to ascertain whether fraud or an illegal act, in fact, occurred or the probability that fraud or an illegal act occurred. However, according to Interpretation No. 26, “Communicating Possible Fraud and Illegal Acts to Management and Others,” of SSARS No. 1 (AR sec. 9100.100–.103), you should consider the impact of the suspected matter on your ability to perform inquiries and other review procedures such as obtaining a management representation letter and keep in mind that the purpose of the review is to express limited assurance that there are no material modifications that should be made to the financial statements for the statements to be in conformity with GAAP.

Question—When during the performance of a compilation or review engagement, the accountant suspects that a fraud or illegal act may have occurred, what steps should be taken in performing the required communication to management?

Answer—According to Interpretation No. 26 of SSARS No. 1 (AR sec. 9100.100–.103), when you suspect that a fraud or an illegal act may have occurred, you should communicate the matter, unless clearly inconsequential, to an appropriate level of management. If the suspected fraud or illegal act involves senior management, the matter should be communicated to an individual or group at the highest level with the entity, such as the manager (owner) or the board of directors. When the suspected fraud or illegal act involves an owner of the business, you should consider resigning from the engagement. Additionally, you should consider consulting with your legal counsel whenever fraud or an illegal act is suspected.

Question—What other parties should be made aware of the illegal act or fraud?

Answer—The disclosure of possible fraud or illegal act to parties other than the client’s senior management is not ordinarily part of your responsibility and in most circumstances would be precluded by your ethical or legal obligations of confidentiality. However, the duty to disclose to parties outside the entity may exist in the following circumstances:

- To comply with certain legal and regulatory requirements.
- To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with SSARS No. 4, *Communications Between Predecessor and Successor Accountants* (AR sec. 400), regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity.
- In response to a subpoena.

Because potential conflicts between your ethical and legal obligations for confidentiality of client matters may be complex, you may wish to consult with legal counsel before discussing such matters with parties outside the client.

QUESTIONS ABOUT INTERIM FINANCIAL STATEMENTS

Question—Is a separate engagement letter required for the interim engagement and the annual engagement?

Answer—No. SSARS No. 1 (AR sec. 100.05) only requires that you establish an understanding with the client, preferably in writing, regarding the services to be performed. If the engagement is to compile financial statements not expected to be used by a third party, the understanding is required to be in writing. If you decide to, or are required to, document the understanding in writing, it is very common to utilize one engagement letter for monthly or quarterly interim engagements and the annual engagement. However, nothing precludes you from using separate engagement letters for the interim engagement and the annual engagement.

Question—An accountant has been engaged to compile monthly financial statements for a client. As this is a recurring engagement, must the accountant prepare monthly compilation procedure checklists and financial statement disclosure checklists?

Answer—SSARS do not require the use of (1) compilation procedure checklists or financial statement disclosure checklists in interim or (2) annual financial statement engagements. The use of checklists is a matter of professional judgment and firm policy.

Question—Is it permissible to issue cash basis interim financial statements and GAAP basis statements at year end?

Answer—Yes. Since the compilation of the interim financial statements and compilation of the year-end financial statements were separate engagements, there is no preclusion from the financial statements being compiled using different bases. However, TPA section 9150.12, “Use of Other Comprehensive Basis of Accounting (OCBOA) for Interim Financial Statements and Generally Accepted Accounting Principles (GAAP) for Annual Financial Statements,” notes that a privately held company may use OCBOA for interim financial statements and GAAP for year-end financial statements. For public companies, OCBOA reporting for interim financial statements is not allowed.

Question—An accountant compiles quarterly financial statements for a landscaping business. Most of the revenues are earned during the summer months. Can the revenue be annualized in the financial statements?

Answer—No. APB Opinion No. 28, *Interim Financial Reporting*, states, “To avoid the possibility that interim results with material seasonal variations may be taken as fairly indicative of the estimated results for a full fiscal year, such businesses should disclose the seasonal nature of their activities, and consider supplementing their interim reports with information for twelve-month periods ended at the interim date for the current and preceding years.” APB Opinion No. 28 does not, however, allow for the revenue to be annualized in the financial statements.

Question—A company uses a different revenue recognition policy in its interim financial statements than in its year-end financial statements. Is this practice permissible? Should the revenue recognition policy be disclosed in the notes?

Answer—No, this practice is not permissible. APB Opinion No. 28 states, “Revenue from products sold or services rendered should be recognized as earned during an interim period on the same basis as followed for the full year.” The revenue recognition policy should be disclosed in the notes to the financial statements.

Question—During an interim engagement, an accountant compiles the financial statements of a client using the gross profit method for valuing inventories. Because of poor economic conditions, the accountant determines that the market value of the inventory is below cost and the decline is not considered temporary. Should the inventory be adjusted to market at the interim date or should the adjustment be made at year end?

Answer—APB Opinion No. 28 states that inventory losses from market declines should not be deferred beyond the interim period in which the decline occurs, so the adjustment should be made at the interim date.

Question—A company has a gain on the disposal of a business unit. Should the gain be reported in the interim period or pro rated over the fiscal year?

Answer—APB Opinion No. 28 notes that extraordinary items, gains or losses from disposal of a component of an entity, and unusual or infrequently occurring items should not be pro-rated over the balance of the fiscal year, but should be reported in the interim period.

Question—An accountant is engaged to compile quarterly financial statements. During the course of the second quarter engagement, the accountant discovers that a check was recorded twice in expenses in the first quarter. The amount is material. Should the first quarter interim financial statements be corrected?

Answer—APB Opinion No. 20, *Accounting Changes*, states that correction of an error in the financial statements of a prior period discovered subsequent to their issuance should be reported as a prior period adjustment. In addition, the nature of an error in previously issued financial statements and the effect of its correction on income before extraordinary items, net income, and the related per share amounts should be disclosed in the period in which the error was discovered and corrected. Financial statements of subsequent periods need not repeat the disclosures.

However, the accountant should advise the client to fully inform third-party users currently relying or likely to rely on the financial statements and the associated report of the subsequently discovered facts and their impact. If the client refuses to communicate with the third parties, the accountant should not agree to compile the financial statements.

Question—An accountant is engaged to review quarterly financial statements. During the third quarter the accountant becomes aware the client is involved in a lawsuit. The event that triggered the lawsuit arose in the first quarter. The client is able to estimate the damages. Should the first and second quarter statements be restated?

Answer—APB Opinion No. 28 states that contingencies and other uncertainties that could be expected to affect the fairness of presentation of financial data at an interim date should be disclosed in interim reports in the same manner required for annual reports. However, APB Opinion No. 20 states that correction of an error in the financial statements of a prior period discovered subsequent to their issuance should be reported as a prior period adjustment. In addition, the nature of an error in previously issued financial statements and the effect of its correction on income before extraordinary items, net income, and the related per share amounts should be disclosed in the period in which the error was discovered and corrected.

Question—An accountant compiles quarterly financial statements for a client using the cash basis. During the second quarter, the client decides that she wants to prepare the statements using the income tax basis of accounting. Do the first quarter statements need to be restated? Must the change be disclosed in the notes? Does an explanatory paragraph need to be added to the report?

Answer—When only current period financial statements are presented, it is common practice to present the effect of the change in the accounting basis by showing beginning retained earnings

as previously reported with an adjustment to convert to the new basis. Although not as common in practice, precedent also exists for either showing opening retained earnings on the new basis or showing the effects of the change as a cumulative-effect adjustment in the income statement. However, according to TPA section 9030.10, “Change From Generally Accepted Accounting Principles (GAAP) to An Other Comprehensive Basis of Accounting (OCBOA) or From OCBOA to GAAP,” if comparative financial statements are presented, the prior period(s) should be restated and presented under the basis to which the company has changed. Restatement is necessary to ensure comparability with all periods presented. In both cases, the change in accounting basis should be disclosed in the notes to the financial statements. According to SSARS, you are not required to add an explanatory paragraph to the compilation report, provided the change is appropriately disclosed in the financial statements. However, nothing precludes you from adding an explanatory paragraph to the compilation report.

Question—An accountant compiles quarterly financial statements. The second quarter shows a loss, but it is estimated that there will be ordinary income for the year. How should the accountant apply the annual effective tax rate to record the quarterly tax benefit or expense?

Answer—APB Opinion No. 28 states that at the end of each interim period the company should make its best estimate of the effective tax rate expected to be applicable for the full fiscal year. The rate so determined should be used in providing for income taxes on a current year-to-date basis. APB Opinion No. 28 further notes that the tax effects of losses that arise in the early portion of a fiscal year should be recognized only when the tax benefits are expected to be (1) realized during the year or (2) recognizable as a deferred tax asset at the end of the year in accordance with the provisions of FASB Statement No. 109, *Accounting for Income Taxes*. An established seasonal pattern of loss in early interim periods offset by income in later interim periods should constitute evidence that realization is more likely than not, unless other evidence indicates the established seasonal pattern will not prevail. The tax effects of losses incurred in early interim periods may be recognized in a later interim period of a fiscal year if their realization, although initially uncertain, later becomes more likely than not. When the tax effects of losses that arise in the early portions of a fiscal year are not recognized in that interim period, no tax provision should be made for income that arises in later interim periods until the tax effects of the previous interim losses are utilized.

Question—May a peer reviewer select interim engagements when performing peer reviews?

Answer—Yes.

QUESTIONS ABOUT FINANCIAL STATEMENTS PREPARED ON AN OTHER COMPREHENSIVE BASIS OF ACCOUNTING

Question—What is considered an “other comprehensive basis of accounting”? What is the source of authoritative guidance for OCBOA financial statements?

Answer—The term *other comprehensive bases of accounting* (OCBOA) refers to bases of accounting other than generally accepted accounting principles (GAAP). The primary guidance for OCBOA financial statements comes from SAS No. 62, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 623). SAS No. 62 (AU sec. 623.04) recognizes the following OCBOAs:

- A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency whose jurisdiction the entity is subject. An example is a basis of accounting insurance companies use pursuant to the rules of a state insurance commission.
- A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements.
- The cash receipts and disbursements basis of accounting, and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing income taxes.
- A definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price-level basis of accounting.

Question—A client requests that its financial statements previously prepared on the income tax basis of accounting be prepared using GAAP. How should the change in accounting basis be reflected in the financial statements? Should the change be disclosed in the notes? Does an explanatory paragraph need to be added to the compilation or review report?

Answer—When only current period financial statements are presented, it is common practice to present the effect of the change in the accounting basis by showing beginning retained earnings as previously reported with an adjustment to convert to the new basis. Although not as common in practice, precedent also exists for either showing opening retained earnings on the new basis or showing the effects of the change as a cumulative-effect adjustment in the income statement. However, according to TPA section 9030.10, if comparative financial statements are presented, the prior period(s) should be restated and presented under the basis to which the company has changed. Restatement is necessary to ensure comparability with all periods presented. In both

cases, the change in accounting basis should be disclosed in the notes to the financial statements. According to SSARS No. 1, you are not required to add an explanatory paragraph to the compilation report, provided the change is appropriately disclosed in the financial statements. However, nothing precludes you from adding an explanatory paragraph to the compilation report.

Question—Can an accountant accept an engagement to compile or review financial statements on one basis of accounting if the accountant previously compiled or reviewed financial statements for the same period on a different basis of accounting?

Answer—Yes. Nothing precludes you from compiling or reviewing financial statements on one basis of accounting when you have previously compiled or reviewed financial statements for the same year on a different basis of accounting.

Question—How should the statement of cash flows be titled since a statement of cash flows is not required when presenting OCBOA financial statements?

Answer—Neither the SSARS, nor SAS No. 62 require specific titles on OCBOA financial statements. However, SAS No. 62 (AU sec. 623.07) states that unmodified GAAP financial statement titles should not be used for OCBOA financial statements.

Question—Is a statement of retained earnings required for OCBOA financial statements? Can the statement of retained earnings be disclosed in the notes?

Answer—APB Opinion No. 9, *Reporting the Results of Operations*, states that the statement of income and the statement of retained earnings (separately or combined) are designed to reflect, in a broad sense, the “results of operations.” Therefore, to present results of operations under GAAP, changes in retained earnings must be disclosed. Based on Interpretation No. 14, “Evaluating the Adequacy of Disclosure in Financial Statements Prepared on the Cash, Modified Cash, or Income Tax Basis of Accounting,” of SAS No. 62 (AU sec. 9623.90), OCBOA financial statements also should disclose the changes in retained earnings when results of operations are presented. This disclosure can be made in a separate financial statement, in the notes to the financial statements, or as part of another basic statement (such as the income statement or balance sheet).

Question—Can the statement of cash flows be disclosed in the notes to OCBOA financial statements?

Answer—Interpretation No. 14 of SAS No. 62 (AU sec. 9623.94) states that OCBOA presentations often include a presentation consisting entirely or mainly of cash receipts and disbursements. Such presentations need not conform with the requirements for a statement of cash flows that would be included in a GAAP presentation. Therefore, the information could be disclosed in the notes to the OCBOA financial statements.

Question—When an accountant is compiling OCBOA financial statements that omit the statement of cash flows, should the accountant reference the omission in his or her report?

Answer—No. Since a statement of cash flows is not required in OCBOA presentations, you do not need to reference the omission in your compilation report.

Question—A company prepares its financial statements on the modified cash basis and does not present a statement of cash flows. It does have material gains from foreign currency transactions. Must a statement of comprehensive income be included?

Answer—According to FASB Statement No. 130, all business entities that have any component of comprehensive income must display information about comprehensive income in a financial statement having the same prominence as the other basic financial statements. However, Interpretation No. 14 of SAS No. 62 (AU sec. 9623.93) states that if GAAP sets forth requirements that apply to the presentation of financial statements, OCBOA statements may either comply with those requirements or provide information that communicates the substance of those requirements. The substance of GAAP presentation requirements may be communicated using qualitative information and without modifying the financial statement format.

Question—A client wishes to have compiled OCBOA financial statements that omit substantially all disclosures. Where should the accountant disclose the basis of accounting used to prepare the financial statements?

Answer—When you compile and report on financial statements that are presented in accordance with an OCBOA and that omit substantially all disclosures, SSARS No. 1 (AR sec. 100.17) requires disclosure of the basis of accounting. This disclosure may be in an attached footnote or in a note on the face of the financial statements. If disclosure is not made as part of the financial

statements, modification of the compilation report would be required. For example, the following sentence would be added to the first paragraph of the standard compilation report: “The financial statements have been prepared on the accounting basis used by the Company for Federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.”

Question—When financial statements are prepared using GAAP, significant accounting policies should be disclosed in the notes. Are OCBOA financial statements required to disclose significant accounting policies?

Answer—Yes. The disclosures required for OCBOA financial statements are essentially the same as those required for GAAP financial statements.

Question—A client requests that an accountant compile income tax basis financial statements to omit disclosures. Can the accountant comply?

Answer—A common misconception about OCBOA financial statements is that the requirements for disclosure are significantly different from those for GAAP financial statements. According to SAS No. 62 (AU sec. 623.09), OCBOA financial statements should include all informative disclosures that are appropriate for the basis of accounting used. Thus, the disclosures required for OCBOA financial statements are essentially the same as those required for GAAP financial statements. Specifically, informative disclosures can be classified in the following categories:

- Summary of significant accounting policies
- Financial statement items
- Presentation requirements
- Other information

QUESTIONS ABOUT PERSONAL FINANCIAL STATEMENTS

Question—Does SSARS apply to the submission of personal financial statements?

Answer—Yes. SSARS No. 1 (AR sec. 100.04) states that a financial statement may be that of an individual.

Question—What is the authoritative guidance for preparing personal financial statements?

Answer—SOP 82-1, *Accounting and Financial Reporting for Personal Financial Statements*, provides guidance on measurement and presentation of personal financial statements. The AICPA Audit and Accounting Guide *Personal Financial Statements Guide*, provides guidance on performance and reporting for audit, review, and compilation of personal financial statements in accordance with SOP 82-1.

Question—Do the same accounting principles apply when preparing personal financial statements as when preparing for-profit business financial statements?

Answer—No. Before the issuance of SOP 82-1, the historical cost basis was considered GAAP for personal financial statements. At that time, GAAP for commercial entities (historical cost) was generally applicable to those personal financial statements. However, SOP 82-1 established the current value basis of accounting as GAAP for personal financial statements.

Question—Is a client representation letter required when compiling or reviewing personal financial statements?

Answer—A client representation letter is required for all review engagements; a client representation letter is not required by SSARS for compilation engagements. However, the AICPA Audit and Accounting Guide *Personal Financial Statements Guide*, recommends that one be obtained. Furthermore, because of the informal nature of most personal financial records, some practitioners obtain written representation from the client to confirm the oral representations made in personal financial statement compilation engagements.

Question—What are the SSARS requirements for personal financial statements included in personal financial plans?

Answer—SSARS No. 6 (AR sec. 600) provides an exemption from SSARS No. 1 (AR sec. 100) for personal financial statements that are included in written personal financial plans prepared by an accountant, and specifies the form of written report required under the exemption. You may submit a written personal financial plan containing unaudited personal financial statements to a client without complying with the requirements of SSARS No. 1 (AR sec. 100) when all the following conditions exist:

- You establish an understanding with the client, preferably in writing, that the financial statements—
 - Will be used solely to assist the client and the client’s advisers to develop the client’s personal financial goals and objectives.
 - Will not be used to obtain credit or for any purposes other than developing these goals and objectives.
- Nothing comes to your attention during the engagement that would cause you to believe that the financial statements will be used to obtain credit or for any purposes other than developing the client’s financial goals and objectives.

APPENDIX A—OTHER SOURCES OF INFORMATION

The following AICPA publications deliver valuable guidance and practical assistance for your engagements.

- *Annual Compilation and Review Alert*
- Practice Aid, *Review Engagements: New and Expanded Guidance on Analytical Procedures and Inquiries*
- *Accounting Trends and Techniques*
- Practice Aid, *Preparing and Reporting on Cash- and Tax-Basis Financial Statements*
- Practice Aid, *Understanding and Implementing SSARS No. 8*
- *Audit and Accounting Manual*

To obtain AICPA publications, receive information about AICPA activities, and find help with your membership questions, call AICPA Service Center Operations at (888) 777-7077 or visit www.cpa2biz.com.

Continuing Professional Education

The AICPA offers a number of self-study and online CPE courses that are valuable to CPAs performing compilation and review services. Visit www.cpa2biz.com for a complete list of CPE courses.

AICPA Technical Hotline and Ethics Hotline

Technical questions about GAAP, OCBOA, accounting, auditing, compilation engagements, review engagements, or other technical matters may be addressed to the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research the question and respond with their answer. The Technical Hotline can be reached at (888) 777-7077.

In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. The Ethics Hotline can be reached at (888) 777-7077.

