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AICPA

VOLUME 1

***Compilation and
Review Manual***

AICPA

INTEGRATED

PRACTICE

SYSTEM

AICPA

V O L U M E 1

Compilation and Review Manual

Authors:

O. Ray Whittington, CPA

Alan J. Winters, CPA

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SEP 28 1992

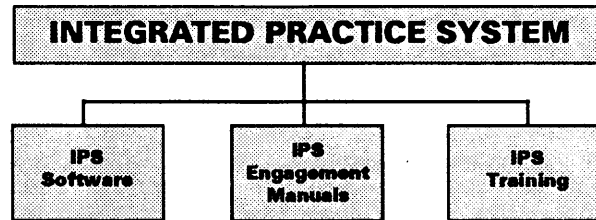
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This manual has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

The manual is issued as a nonauthoritative kit of practice aids and is not intended as a substitute for professional judgments or for authoritative technical literature.

The documentation in this manual is not a substitute for development and implementation by a firm of a system of quality control that is appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.

The AICPA Integrated Practice System: For CPAs Concerned About Quality and Profitability



The Integrated Practice System (IPS) gives practitioners the tools they need to conduct high-quality and cost-effective engagements. How? By enabling CPAs to anticipate engagement problems and by putting the solutions to these problems — integrated engagement manuals, software products, and training resources — within their grasp.

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- Include copies of the relevant authoritative and non-authoritative literature, such as audit risk alerts, industry audit and accounting guides, updated industry checklists, and more.
- Receive ongoing review and evaluation from a task force of the AICPA's Private Companies Practice Section (PCPS) — CPAs who confront similar challenges in their practices and who represent the interests of local and regional firms.
- Include a 60-day "no-questions-asked" return guarantee that allows you the time to try the IPS products and find out for yourself how your firm and staff can benefit from them.
- Are backed by the credibility and prestige of the American Institute of Certified Public Accountants.

■ **IPS ENGAGEMENT MANUALS: THE SMART KID ON THE BLOCK**

Finally, there is a reliable, step-by-step approach for managing and performing your engagements. The IPS Engagement Manuals point you in the right direction with time-saving tools you need to conduct high-quality engagements with the greatest efficiency. Right from the start, IPS Engagement Manuals show you a direct route to protecting your bottom line. You can minimize on-site fieldwork and put an end to “over-auditing” because our exclusive “ABC System” helps you evaluate risk in the critical planning stage. You’ll find important guidelines to use in evaluating your client, so that you can adjust the level of testing to the internal controls employed by the client.

The IPS Engagement Manuals, formerly called the “Small Firm Library Series,” feature a practical, “how-to” approach that enables you and your staff to cut through the clutter and focus on what’s important. By eliminating time-consuming guesswork, they chart the course to the most cost-effective, efficient way of proceeding with your engagement. Plus, the manuals include ready-to-use forms, audit programs, checklists, and questionnaires — even sample correspondence to speed your work.

Each IPS Engagement Manual includes

- Guidance based on the most recent relevant authoritative and non-authoritative literature;
- Integrated work programs and checklists — even a microcomputer checklist;
- Model letters ready for your use;
- Time-saving worksheets that capture important information and also help users identify opportunities for other services that can be provided to existing clients, such as consulting and tax services and the preparation of prospective financial information.

What’s more, IPS Engagement Manuals ease the process of quality review by providing you with the documentation you need. And, because they’re published by the AICPA, you can be confident that they’re reliable.

The IPS Engagement Manuals can be easily used as stand-alone practice aids. Or, you can use them in conjunction with the full complement of IPS software — including the AICPA’s very successful Accountant’s Trial Balance (ATB) and Audit Program Generator (APG). It’s the flexibility you need for a cost-efficient, high-quality engagement.

The AICPA recognizes your need to be up-to-date on issues that affect your clients — that’s why subscribers automatically receive annual updates for the engagement manuals. Our goal, pure and simple: to provide the answers to your questions even before you ask them.

Because the AICPA has an ongoing commitment to developing the practice aids you need to serve your clients, it will continue to release new industry-specific manuals. These will contain the same kind of practical tools and how-to guidance that are the hallmarks of the IPS Engagement Manuals.

Comprehensive Engagement Manual

The *Comprehensive Engagement Manual* can help practitioners manage most engagements. Designed to be the accountant’s companion to audit, review, and compilation engagements, the manual includes checklists, forms, flowcharts, questionnaires, tables, and all the documentation necessary for any size engagement.

This four-volume set covers engagement performance, documentation and reporting, and helps you make key decisions, including

- Assessing risk and establishing materiality limits;
- Selecting the most cost-beneficial audit approach;
- Designing the most economical auditing procedures; and
- Making sampling decisions that maximize efficiency.

The *Comprehensive Engagement Manual* features the unique and highly-popular “ABC System” that enables practitioners to identify the most cost-beneficial mix of tests of controls, substantive tests of balances, and analytical procedures for specific engagements.

Small Business Audit Manual

The two-volume *Small Business Audit Manual*, an alternative to the *Comprehensive Engagement Manual*, walks you through each step of the audit of a small business. It helps you to

- Plan a cost-effective and time-efficient engagement;
- Verify all financial statement assertions;
- Understand a client’s internal control structure and assess control risk;
- Better understand how to apply authoritative standards to small business audits;
- Evaluate a small business’ microcomputer needs.

The *Small Business Audit Manual* also puts at your fingertips sample audit programs, questionnaires, journal entries, model letters, time sheets, and workpapers for each stage of a small business audit engagement — organized in the sequence they will be used.

Bank Audit Manual

The three-volume *Bank Audit Manual* can help you cope with the high risk generally associated with bank audits and the complexity of bank operations. It is designed to enable you to perform high-quality engagements with maximum time savings. It does so by including

- A framework to help practitioners select the most cost-effective audit approach;
- Worksheets and forms to help auditors understand a bank’s internal controls and assess risk during engagement planning;
- Programs for interim work;
- Sampling documentation and discussions of professional standards that affect the sampling decision;
- Worksheets for various analytical procedures that can help to identify errors and irregularities;
- The most recent AICPA Audit Risk Alert, *Banking Industry Developments*;
- The most recent AICPA Audit and Accounting Guide, *Audits of Banks*.

Construction Contractors’ Audit Manual

You’ll find this two-volume manual your most valuable practice aid when working on engagements for construction contractors. It contains

- Practical, how-to guidance for completing construction contractor audits;
- All the necessary audit programs, forms, checklists, sample correspondence and workpapers to comply with today’s quality control standards;
- A supplemental tax preparation checklist specific for construction contractors;
- The AICPA *Audit Risk Alert for Construction Contractors* which highlights how recent economic, regulatory and professional developments may affect audits of construction contractors;
- The AICPA Audit and Accounting Guide, *Construction Contractors*, which contains discussions on the applicability of specific professional standards to engagements for construction contractors.

Compilation and Review Manual

This two-volume set provides a step-by-step system to help you conduct high-quality compilation and review engagements — profitably and in compliance with professional standards. It includes

- Integrated compilation and review work programs, forms, checklists, workpapers, and correspondence;
- Expert guidance on applying authoritative standards to everyday situations;
- Compilation and review reporting checklist, with reference excerpts from applicable authoritative standards;
- Illustrative financial statements and disclosures.

Credit Union Manual

The two-volume manual outlines the most efficient way to approach audits of credit unions and contains guidance on conducting them in compliance with current professional standards. The manuals contain

- Audit programs, forms, checklists, workpapers, and illustrations necessary to perform credit union audits and supervisory examinations;
- The AICPA Audit and Accounting Guide, *Audits of Credit Unions*;
- The latest AICPA *Audit Risk Alert for Credit Unions*;
- The most recent checklists and illustrative financial statements for credit unions;
- Guidance on applying SOP 90-11, *Disclosure of Certain Information by Financial Institutions*.

▲ **IPS SOFTWARE — THE ELECTRONIC EDGE**

IPS software products — Accountant's Trial Balance (ATB) and its modules, Audit Program Generator (APG), and Engagement Manager (EM), among others — put the solutions to daily practice problems at your fingertips. Together with IPS Engagement Manuals, they streamline engagement planning and performance, and enable you to more effectively monitor your staff and your budget. Most importantly, they prevent you from reinventing the wheel each time you plan and conduct an engagement.

It's easy to put these products to work for you. IPS software requires an IBM PC, XT, AT, PS/2 or IBM-compatible system and DOS version 3.1 or higher. A team of professionals is available to answer any of your questions; simply call the AICPA Software Support Hotline at (212) 575-5412 or use the Institute's Software ExpressFAX service at (212) 575-5334.

Accountants Trial Balance

ATB, the best-selling, most-used accounting software in the profession today, is an integral part of the IPS family. Designed *by* accountants *for* accountants and used by approximately 9,000 accounting firms, ATB automates much of the routine work associated with trial balance and financial statement preparation. Specifically, it

- Generates picture-perfect workpapers, including trial balances, journals, lead schedules, user definable grouping schedules, and analytical review worksheets;
- Enables users to prepare trial balances based on GAAP, federal tax, state tax, or other user-selected accounting bases;
- Keeps up to five years of data on file for any one client, enabling you to generate a variety of comparative reports quickly and simply.

Modules for Use with ATB 3.0

- *ATB Financial Statements* — This powerful report writer enables you to produce final financial statements quickly and easily.
- *ATB Consolidations* — This module enables you to consolidate trial balances from up to nine individual companies into one ATB company trial balance — with ATB automatically keeping track of all activities.
- *ATB Conversion* — With ATB Conversion you can transfer any data electronically from a number of general ledger and workpaper packages to ATB and from ATB to leading corporate tax preparation packages.

Audit Program Generator

The Audit Program Generator (APG) is the only software package that enables you to customize an audit program or a checklist to a particular client. Its unique features help you save time and unnecessary expense in conducting audits. Since its introduction in 1987, over 8,000 firms have used APG.

APG Version 2.0 enables you to

- Create a variety of programs and checklists, including audit programs, disclosure checklists, and compliance checklists;
- Tailor the audit program to the needs of your specific client;
- Customize programs from a wide variety of sample AICPA work programs available in electronic format;
- Quickly link your audit procedures and financial statement assertions;
- Use a full-text editor to customize titles and footers and create appropriate tabular formats.

Engagement Manager

The Engagement Manager software package can assist you in planning, analyzing, documenting, and correcting engagement management problems — and free up valuable staff time in the process. Most importantly, it handles the details of creating and modifying budgets, recording actual time and expenses, and comparing results so you can devote your energy to other aspects of your business. With the Engagement Manager's help, you can

- Anticipate potential budget variances and delays through a variety of analytical reports;
- Spot potential problems while there is time to take action; and
- Determine the effectiveness of individual staff members by analyzing their efficiency in assigned areas.

AICPA Depreciation

This new AICPA software product provides a simple and efficient means of calculating and tracking how assets are depreciated. It calculates depreciation for six separate reporting bases: book, federal, state, AMT, ACE, and "other." What's more, it lets you apply various methods of depreciation to any of these reports and prints out complete worksheets showing changes in various property accounts and the necessary journal entries to record depreciation for the year.

Reports generated through AICPA Depreciation include:

- Depreciation schedules by category, G/L account number, system, or convention
- Summarized worksheet information for Forms 4255, 4562, 4626, 4797, 6252, and Schedule D
- AMT preference calculation
- ACE adjustment calculation
- Fully depreciated assets report
- Amortization report
- Section 179 deduction report
- ITC taken report
- Basis comparison
- Depreciation account reconciliation
- Amortization account reconciliation
- Schedule M-1 information
- Overridden calculations

▲ IPS TRAINING RESOURCES: MAKING IPS WORK FOR YOU

Whether you're a user of one or more IPS products or you're looking for ways to more effectively manage engagements, IPS Training Resources can benefit you. You'll learn how IPS Engagement Manuals and Software can help your practice run more smoothly and how the system works to facilitate productivity, efficiency, and quality performance by you and your staff.

IPS Training Resources come in three formats: self study or self-administered group study; customized in-house group study; and conferences. Here is what's available in each format:

Self Study or Self-Administered Group Study

An *Orientation and Technical Update Seminar* is a formal group study-program designed to assist firms with initially implementing the IPS Engagement Manuals. It also provides a monitored self-study orientation on the manuals for new staff. The seminar materials can help you to better understand and apply common SASs in the most efficient manner. You'll learn how to design tests, auditing procedures and sample sizes to collect the right amount of evidence needed for particular engagements.

Accountant's Trial Balance - CPE Edition is a self-study course that teaches you how to automate your workpapers for all types of engagements. You'll earn eight hours of CPE credit as you become familiar with ATB and its most used features for audits, reviews, compilations, and tax workpapers.

Accountants Trial Balance With Financial Statement Generator -CPE Edition is a self-study course that enables you to rapidly learn the basics of ATB and the Financial Statement Generator add-on module. The recommended CPE credit for this course is eight hours.

Customized In-House Group Study

Special in-firm training is available to demonstrate how your firm can put IPS products to use. And you'll see immediate results. That's because the training leader will use a current client engagement *you select* as the training model. Whether you select a one- or two-day training program, you'll learn how IPS products can help you address real client needs and resolve specific client problems.

AICPA Conferences

Training sessions focusing on IPS Engagement Manuals and Software are part of many AICPA conferences designed for local and regional practitioners, including the highly rated PCPS Conference, National Accounting and Auditing Technical Symposium, Small Firm Conferences, and Practice Management Conferences.

The AICPA also sponsors an annual Software Users Conference — a “roll-up-your-sleeves” conference providing practical advice for both current and potential users of Accountants Trial Balance, Audit Program Generator, and Engagement Manager, as well as users of other AICPA software.

For 1992, IPS training programs — which provide CPE credit — have been scheduled at the following AICPA conferences and seminars:

- | | |
|--|--------------------------|
| • PCPS Conference | May 1992 |
| • National Accounting and Auditing
Advanced Technical Symposium | June and July 1992 |
| • Practice Management Conference | July and September 1992 |
| • Small Firm Conference | August and November 1992 |
| • Software Users Conference | September 1992 |

To schedule in-firm training or to obtain more information about IPS Training Resources, including dates and locations of these conferences, call the AICPA Technical Information Division at (212) 575-6432.

COMPILATION AND REVIEW MANUAL

Preface

The AICPA *Compilation and Review Manual* is a complete tool for performing and reporting on compilations and reviews of financial statements. The overall approach to performing compilations and reviews presented in this Manual is designed to maximize quality and efficiency. The Manual provides all necessary checklists, work programs, and sample correspondence and reports to perform the most cost-beneficial and quality engagements.

The Manual is designed to comply with all applicable authoritative pronouncements. References are made throughout to the pronouncements and cited to paragraph numbers in the *Statements on Standards for Accounting and Review Services* (SSARS) and related *Interpretations*. Also, a summary of an exposure draft of a proposed SSARS statement that would affect the performance and reporting of compilation and review engagements is included in the Introduction chapter. Practitioners are encouraged to refer directly to the applicable technical literature.

This two-volume Manual contains all the documentation, including quality control and management and supervision documents, necessary to complete a compilation or review engagement, arranged in the order normally needed in the engagement:

- Client Acceptance Form
- Form for Documenting Understanding of Client's Business and Industry
- Sample Engagement Letter
- Client Service Agreement
- Computerized Accounting Processing Form
- Compilation/Review Engagement Work Program
- Engagement Checklist
- Technical Review Checklist
- Signer's Checklist
- Financial Statement Disclosure Checklist
- Sample Documentation Forms
- Sample Representation Letter
- Sample Compilation/Review Reports

The Manual also contains chapters addressing special compilation and review reporting engagements such as the following:

- Personal financial statements
- Financial statements in prescribed forms

- Specified elements, accounts, or items in a financial statement
- Special-purpose financial presentations to comply with contractual agreements or regulatory provisions
- Development stage companies
- Other Comprehensive Bases of Accounting
- Common Interest Realty Associations

To provide you with ready access to useful SSARS guidance, the appendixes to the Manual contain all SSARS Interpretations issued to date, and all Qs and As from the AICPA *Technical Practice Aids* pertaining to compilation and review services. In addition, numerous "Practice Tip" sections included throughout the Manual provide helpful hints about applying SSARS in practice.

The Compilation and Review Manual maximizes opportunities for additional services. Its questionnaires and checklists are sources of meaningful suggestions that can be presented to clients and that can result in wider service offerings.

Software

All work programs and checklists in the *Compilation and Review Manual* are available in electronic format for use with the AICPA's *Audit Program Generator* (APG2) software.

Training

The AICPA has developed formal training sessions for practitioners on how to implement the IPS Engagement Manuals in an accounting practice. Presently, these sessions are conducted at various AICPA conferences throughout the year in cities nationwide. For 1992, special sessions specifically geared to implementing the *Compilation and Review Manual* in an accounting practice will be presented at the *AICPA National Small Firm Conference* to be held August 19-21 in Chicago and November 4-6 in Phoenix; and at the *AICPA National Practice Management Conference/National Marketing Conference* to be held October 25-28 in Orlando. For more information on these and other training sessions please call (212) 575-6432.

IPS Manual Advisory Task Force

The manuals in the AICPA Integrated Practice System (IPS) are monitored by a special PCPS IPS Manual Advisory Task Force. Task force members use the manuals in their audit and accounting practices and continuously provide the AICPA staff with recommendations to enhance the manuals from the perspective of the small and medium-size firm.

Members of the AICPA Private Companies Practice Section (PCPS) IPS Manual Advisory Task Force (1991)

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Mr. Whittington received his M.S.—Accountancy from Texas Tech University and his Ph.D. from the University of Houston. He has served on numerous professional committees and task forces, including the AICPA Statistical Audit Subcommittee and the Audit of Accounting Estimates Task Force.

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Mr. Winters served as a consultant on the Treadway Commission's Sponsoring Organizations' project to develop criteria for internal control (COSO) and is a member of the AICPA's task force developing standards for auditing internal control.

Mr. Winters holds a Ph.D. from Texas Tech University and was formerly professor of accounting at Louisiana State University. He has been associated with national and local accounting firms and has been a consultant to several accounting firms in the area of technical policy and audit litigation. Mr. Winters is a co-author of a leading auditing textbook published by Harcourt Brace Jovanovich and contributed a chapter on generally accepted auditing standards to an accounting and auditing handbook recently published by Wiley & Co. He has also developed many continuing professional education courses for CPAs and has published articles in numerous professional and academic journals.

SUGGESTED REVISIONS TO MANUALS

Please submit all suggestions to improve the quality of this Manual as they arise. We value users' input and will give all comments consideration when revising the Manual.

To:
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From:

(Name)

(Firm)

(Address)

(Telephone No.)

Manual: Compilation and Review Manual

Suggested Revisions:

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CHAPTER 1
INTRODUCTION

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CHAPTER 1

INTRODUCTION

1.000 OBJECTIVES OF THE MANUAL

1.001 This manual provides clear, practical, up-to-date guidance for accountants engaged to perform accounting and review services. The manual has been prepared to make this guidance easy to find and easy to apply.

1.002 The manual's primary purpose is to provide all the guidance, work programs, checklists, sample correspondence, reports, and forms necessary to perform quality compilation and review engagements in the most cost-beneficial manner and in compliance with all applicable authoritative pronouncements. It also is designed to help the accountant solve every day practice problems encountered in compilation and review engagements. The manual also is well-suited for training firm staff and as a firm manual for peer review and quality review.

1.100 ORGANIZATION AND CONTENT OF THE MANUAL

1.101 The manual consists of thirteen chapters contained in two loose-leaf binders. Chapters 1 through 7 are presented in volume one, and Chapters 8 through 13 plus two appendixes are presented in volume two. The first volume discusses when Statements on Standards for Accounting and Review Services (SSARS) apply to an accounting firm, administration of compilation and review service engagements, and performing and reporting on compilation and review services. The second volume covers more specialized topics including reporting on comparative financial statements, financial statements prepared on an other comprehensive basis of accounting, prescribed forms, personal financial statements, special-report engagements, and illustrative financial statements and disclosures.

1.102 The first appendix is a reprint of all SSARS Interpretations and the second appendix is a reprint of Qs and As from the AICPA Technical Practice Aids (TPAs) pertaining to compilation and review services. These appendixes provide ready access to useful SSARS guidance.

1.103 Each paragraph in the manual is assigned a four-digit number; for example, this paragraph is 1.103. The first digit is the chapter number, the second digit identifies the topic (subheading) discussed in the paragraph, and the last two digits identify the paragraph number. Thus, in the reference 1.103, the first digit, (1), refers to Chapter 1, the second digit, (1), refers to the chapter section, and the last two digits, (03), refer to the paragraph number.

1.104 Page numbers appear at the bottom of each page. The number(s) before the hyphen represent the chapter number while the numbers after the hyphen represent the page number.

1.105 Where appropriate, chapters contain a documentation assistance section, sample reports, and financial statement format and disclosure illustrations. These sections provide checklists, work programs, and examples of letters, reports, and financial statements to make the guidance in the manual easy to apply and document. In addition, "Practice Tips" (boxed areas) included throughout the manual provide helpful hints about applying SSARS to practice.

1.200 HOW TO USE THIS MANUAL

1.201 The chapters in this manual are organized to help users locate a particular practice area. Each chapter is devoted to a specific topic accountants are likely to encounter in compilation and review engagements. For example, for compilation engagements, Chapter 4 discusses the performance requirements while the following chapter, 5, discusses reporting requirements. Thus, once the user identifies the specific engagement area where guidance is needed, he or she can readily go the chapter that is likely to provide it.

1.202 The remaining paragraphs in this section provide an overview of chapter contents to familiarize users with the manual. In addition, section 1.300 of this chapter is a summary of an exposure draft of a proposed SSARS. This exposure draft proposes numerous changes to SSARS which, if made final, would change some of the guidance in this manual. The authors suggest that you review this summary and monitor the status of this proposed standard. At appropriate places in the manual, the authors have provided reminders of each proposal and its potential effect on the specific guidance discussed.

1.203 Chapter 2 provides detailed guidance to help the accountant determine whether SSARS apply to a particular service. The authors have found that the applicability of SSARS is not always well understood. In addition, the AICPA's Accounting and Review Services Committee recently issued additional guidance to help clarify applicability questions. We encourage you to read this chapter carefully

before deciding whether SSARS apply to a specific engagement.

1.204 Chapter 3 provides guidance, recommendations, and documentation forms for engagement administration. Areas that are common to both compilation and review engagements, such as client acceptance, are discussed, as well as areas that are specific to only one type of engagement.

1.205 Chapters 4 and 5 pertain to performing compilation engagements and reporting on those engagements, respectively. This division by engagement category allows the accountant to focus on the specific engagement as well as the particular segment of the engagement being performed. Chapter 4 provides the forms necessary to execute and document the performance requirements for compilations contained in SSARS. Chapter 5 provides various compilation report illustrations, thus addressing virtually all of the reporting situations an accountant might encounter in a compilation engagement.

1.206 Chapters 6 and 7 pertain to performing review engagements and reporting on those engagements, respectively. Again, it allows the accountant to focus on the particular type and segment of engagement under consideration. Chapter 6 includes the forms necessary to execute and document review engagement performance requirements, such as analytical procedures work programs. Chapter 7 contains numerous review report illustrations, covering virtually all of the reporting situations an accountant might encounter in a review engagement.

1.207 In volume 2, Chapter 8 discusses reporting requirements for comparative financial statements and provides report examples for essentially any comparative reporting situation. Chapters 9, 10, and 11 address special applications of SSARS to engagements involving other comprehensive bases of accounting, prescribed forms, and personal financial statements, respectively. Each chapter discusses both the performance and reporting requirements pertinent to each topic.

1.208 Chapter 12 provides guidance for special report situations such as reporting on specified elements, accounts, or items of a financial statement; financial presentations in conformity with contractual or regulatory requirements; and other special circumstances.

1.209 Chapter 13 describes selected financial statement disclosures and provides additional illustrative financial statements for certain specialized entities, such as common interest realty associations and development stage enterprises.

1.300 SUMMARY OF THE EXPOSURE DRAFT OF PROPOSED SSARS NO. 7, OMNIBUS STATEMENT

1.301 At the time this manual was printed, the Accounting and Review Services Committee (ARSC) had issued an exposure draft of proposed Statement on Standards for Accounting and Review Services No. 7 (proposed SSARS). The comment deadline on the exposure draft is June 30, 1992 and the authors expect the final statement to be issued in the fourth quarter of 1992.

1.302 The proposed SSARS is an omnibus statement in that it proposes amendments to existing SSARS Nos. 1 through 6 in 10 different areas. Some of the amendments are more significant than others. This summary reviews these amendments and indicates how they will change the guidance in this manual if they are issued in a final statement. In addition, these proposed amendments are highlighted in the sections of the manual where they would cause changes.

1.303 Users of this manual should determine whether the proposed SSARS has been issued as a final statement when they use the guidance in sections where the proposed amendments are highlighted. The next revision of this manual will incorporate any amendments that are made final through the issuance of a SSARS pronouncement. The following paragraphs summarize the details of the major provisions of the proposed SSARS.

Modification of Compilation and Review Reports

1.304 This amendment proposes to revise the SSARS review report to differentiate it from a review of interim financial information performed under Statements on Auditing Standards (SASs). The SAS review is more extensive than a SSARS review, and the similarity between the SAS and SSARS review reports could cause financial statement users to assume that the requirements of a SAS review have been fulfilled.

1.305 Specifically, the proposed amendment changes the reference in the first paragraph of the SSARS review report from "standards established by the American Institute of Certified Public Accountants" to "Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants." This reference would also be changed in the standard compilation report to maintain consistency with the review report reference.

1.306 This proposed amendment would affect all compilation and review reports issued under SSARS Nos. 1, 2, and 3. Therefore, users of this manual should determine the current status of the exposure draft before drafting a compilation or

review report. The authors recommend that accountants do not adopt the report amendment prior to the issuance of a final SSARS. This amendment to SSARS is based on a proposed change in the SAS review engagement. There is no need to differentiate the two types of reviews until the proposed SAS revision becomes final.

Client Representation Letter

1.307 This amendment proposes to revise the performance standards in SSARS to require that the accountant obtain a client representation letter in all review engagements. Currently, SSARS states that a representation letter is optional in review engagements. In addition, the amendment states that if the accountant is unable to obtain the representation letter, a review report cannot be issued.

1.308 Many accountants already obtain client representation letters in review engagements. The authors recommend that this proposed amendment be adopted currently by accountants who do not already obtain such letters in reviews.

1.309 Regardless of whether the accountant is required or elects to obtain a representation letter, he or she may want to put the client on notice that such a letter will be requested by including a statement to that effect in the engagement letter.

Typing or Reproducing Financial Statements

1.310 This amendment proposes to delete the sentence in Paragraph 7 of SSARS No. 1 that prohibits the accountant from merely typing or reproducing financial statements as an accommodation to the client. Thus, if this amendment is made final, accountants could type or reproduce financial statements for their clients without having to comply with the requirements of SSARS No. 1.

1.311 The authors recommend that accountants do not adopt this amendment before it becomes final. Even though SSARS No. 1, Interpretation No. 16, *Determining If the Accountant has Submitted Financial Statements Even When Not Engaged to Compile or Review Financial Statements*, permits the accountant to type or reproduce financial statements for his or her client, it is not as authoritative as a SSARS.

Recognition of GAAP Hierarchy

1.312 This proposed amendment would clarify that the GAAP hierarchy set forth in SAS No. 69, *The Meaning of 'Present Fairly in Conformity With Generally Accepted*

Accounting Principles' in the Independent Auditor's Report, applies to compilation and review engagements performed under SSARS.

1.313 The authors believe that most accountants use the GAAP hierarchy in compilation and review engagements and this manual has incorporated this view. For those accountants who are not currently applying the GAAP hierarchy to such engagements, the authors recommend that they adopt this proposed amendment currently. A detailed discussion of the GAAP hierarchy is contained in Chapters 5 and 7 of this manual.

Communications About Errors, Irregularities, and Illegal Acts

1.314 This proposed amendment makes it clear that the accountant is not required to communicate information about errors, irregularities, and illegal acts that come to the accountant's attention when they are clearly inconsequential. This position already exists in SASs and the amendment would make SSARS consistent with the SASs.

1.315 Specifically, the proposed amendment would change paragraph No. 8 of SSARS No. 1 and would also affect the illustrative engagement letters for compilation and review engagements.

1.316 The authors recommend that accountants adopt this amendment currently only if they modify the engagement letter to communicate this responsibility.

Uncertainties and Going Concern

1.317 This proposed amendment makes clear that an *uncertainty* includes going concern matters and, therefore, the accountant is not required to modify the compilation or review report as long as the uncertainty about the ability of the entity to continue as a going concern is appropriately disclosed in the notes to the financial statements.

1.318 The proposed amendment also reminds accountants that in evaluating the disclosure of going concern uncertainties, they should look to the guidance in paragraphs 10 and 11 of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*.

1.319 This guidance has been incorporated in the manual and the authors recommend that accountants apply that guidance currently.

Communication Between Predecessor and Successor Accountants

1.320 This proposed amendment is actually a clarification. SSARS No. 4 would be modified to clearly indicate that a successor accountant who becomes aware of information that leads him or her to believe that the financial statements reported on by the predecessor accountant may require revision, is required to request that the client communicate this information to the predecessor.

1.321 The proposed amendment also corrects an inappropriate implication in SSARS No. 4 that SAS No. 7, *Communication Between Predecessor and Successor Auditors*, applies when a change is made from a compilation or a review to an audit. This is not the case--communication with the predecessor accountant is optional in this situation.

1.322 The authors recommend that accountants adopt these proposed amendments currently.

Change From a Review to a Compilation

1.323 This amendment proposes to clarify paragraphs 44 through 49 of SSARS No. 1, concerning a change from an audit to a review or compilation engagement, to indicate that such guidance also applies to a change from a review to a compilation engagement.

1.324 The authors recommend that accountants adopt this proposed amendment currently.

SSARS No. 5

1.325 This proposed amendment would withdraw SSARS No. 5, *Reporting on Compiled Financial Statements*, because the guidance in that statement already is incorporated in SSARS Nos. 1, 2, and 3.

1.326 This amendment has no effect on current practice.

1.400 LISTING OF SSARS PRONOUNCEMENTS

1.401 Table 1-1 lists the SSARS currently in effect. The SSARS *Interpretations* are reprinted in Appendix A (in volume 2) of this manual. The full text of the SSARS pronouncements are in the AICPA *Professional Standards*, volume 2 (Product No. 005011), and in the AICPA's *Codification of Statements on Standards for Accounting and Review Services* (Product No. 057162).

Table 1-1

STATEMENTS ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES (SSARS)

- No. 1 *Compilation and Review of Financial Statements* (December, 1978)
- No. 2 *Reporting on Comparative Financial Statements* (October, 1979)
- No. 3 *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (December, 1981)
- No. 4 *Communication Between Predecessor and Successor Accountants*
(December, 1981)
- No. 5 *Reporting on Compiled Financial Statements* (July, 1982)
- No. 6 *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (September, 1986)

CHAPTER 2
DETERMINING IF SSARS APPLIES

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CHAPTER 2

DETERMINING IF SSARS APPLIES

2.000 GENERAL APPLICABILITY CONSIDERATIONS

2.001 Accountants are required to follow SSARS only when certain conditions are met. Therefore, it is important to determine whether those conditions exist in the engagement to ensure that SSARS is followed when it applies and also to avoid applying those standards unnecessarily.

2.002 Generally, SSARS must be followed when an accountant either compiles or reviews historical financial statements of a nonpublic entity. Thus, the significant applicability considerations are the terms compile, review, financial statements, and nonpublic entity. Each of these terms is discussed in the sections that follow. In addition, other considerations that may raise questions about whether SSARS applies to an engagement are also discussed in this chapter.

Nonpublic Entity

2.003 SSARS defines nonpublic entities by exception. A nonpublic entity is--

Any entity other than (a) one whose securities trade in a public market on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b).

Thus, if an entity does not fall into either category (a), (b), or (c) in the above definition, it is a nonpublic entity.

Financial Statements

2.004 SSARS applies only to financial statements. Thus, an accountant may provide other types of financial presentations such as a trial balance, summary of

financial ratios, or report of operating statistics, without following SSARS. (Additional guidance about what is and what is not a financial statement is in paragraphs 2.108 through 2.113.)

2.100 COMPILATION SERVICES

2.101 Paragraph 4 of SSARS No. 1 defines a compilation as--

Presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements.

2.102 Thus, a compilation, per se, is limited to taking information provided by management and putting it in financial statement format. The SSARS definition of compiling presumes the information is available and that management assumes responsibility for it. A compilation service, as defined in SSARS, does not include any other services the accountant may need to perform to obtain the information that is to be presented in financial statement form. Although SSARS does recognize that the accountant may need to perform such services, they are not compilation services and, therefore, the accountant is not required to apply SSARS to those other services. This distinction in accounting services is an important consideration in determining whether SSARS applies and is discussed in detail in paragraphs 2.114 through 2.122.

2.103 A compilation service is not intended to and does not express any assurance by the accountant about whether the financial statements conform with GAAP or OCBOA requirements. The sole purpose of a compilation engagement is to present information in financial statement form. (Guidance about accountants' reports on compilation engagements is provided in Chapter 5.)

Overview of Performance and Reporting Requirements in Compilations

2.104 As discussed in detail in Chapters 4 and 5, an accountant who compiles financial statements must meet five specific performance requirements as well as certain reporting requirements. In general, these requirements are:

- Establish an understanding with the client regarding the services to be performed and the report the accountant expects to render.
- Have or obtain knowledge of the accounting principles and practices of the client's industry and a general understanding of certain matters related to the client itself.
- Consider whether it will be necessary to perform other accounting

services, such as assistance in adjusting the books of account or consultation on accounting matters.

- Take certain actions when the accountant becomes aware that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory.
- Read the compiled financial statements and consider whether they appear to be appropriate in form and free from obvious material error.
- Consider whether to modify his or her report if in the compilation of the financial statements the accountant becomes aware of a departure from GAAP (or OCBOA) that is material to the financial statements and the financial statements are not revised.

Because specific performance and reporting requirements exist for compilation services, determining whether a compilation service has been or should be performed is a critical consideration in deciding if SSARS applies.

When Should Financial Statements Be Compiled?

2.105 SSARS recognizes three basic circumstances for which a compilation service should be performed. The first circumstance is an obvious one: When an accountant is engaged to compile financial statements. Thus, if your client engages you to compile financial statements you must follow SSARS.

2.106 The second circumstance is less obvious. SSARS requires accountants who submit unaudited financial statements of a nonpublic entity to their clients or others, as a minimum, to compile those financial statements and, therefore, to follow SSARS. This circumstance is not necessarily engagement driven. That is, even though the client has not specifically engaged the accountant to compile financial statements, submitting financial statements triggers the requirement to apply SSARS performance and reporting standards. (Additional guidance about what constitutes submission of financial statements is in paragraphs 2.114 through 2.122.)

Practice Tip:

If you contemplate that services for your nonpublic client will result in you submitting unaudited financial statements to your client or others, make sure your client understands early in the engagement that a compilation will be required. For example, some management consulting services may result in the accountant submitting financial statements to the client or other parties. Such financial statements would have to be compiled in accordance with SSARS even though they may be considered a by-product of the consulting service.

2.107 The third circumstance involves use of the accountant's name in a document or written communication containing unaudited financial statements of a nonpublic entity. SSARS states that the accountant should not consent to the use of his or her name in such circumstances unless (a) the accountant has compiled (or reviewed) the statements and reports on them, or (b) the financial statements are accompanied by an indication that the accountant has not compiled or reviewed them and assumes no responsibility for them.

What Is and Is Not a Financial Statement?

2.108 SSARS establishes standards for compilation and review of financial statements of nonpublic entities. Therefore, it applies only to financial statements. As a result, deciding whether a financial presentation is a financial statement is foremost in determining whether the accountant must follow SSARS.

2.109 Specifically, SSARS 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 generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles.

SSARS also gives the following specific examples of financial statements:

- Balance sheet
- Statement of income
- Statement of retained earnings
- Statement of cash flows
- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without equity accounts)
- Statement of revenue and expenses
- Summary of operations
- Statement of operations by product lines
- Statement of cash receipts and disbursements

2.110 Notice that the definition and examples cover not only GAAP-based financial statements but also OCBOA financial statements such as those prepared using the cash basis or income tax basis. In addition, a financial statement may be that of a corporation, partnership, proprietorship, combined group of affiliated entities, not-for-profit organization, governmental unit, estate or trust, a segment of any of these, or an individual. Furthermore, notice that the financial statements to which SSARS applies are historical financial statements only.

2.111 Some financial presentations have characteristics that make them difficult to classify as either a financial statement or some other type of presentation. SSARS No. 1, Interpretation No. 15, *Differentiating a Financial Statement Presentation From a Trial Balance*, provides guidance in distinguishing a financial statement from a trial balance--a frequently encountered problem. This guidance, however, is also helpful in differentiating financial statements from other types of presentations as well.

2.112 Interpretation No. 15 identifies specific characteristics of financial statements that distinguish them from a trial balance. These characteristics are described and discussed below:

- Account Presentation - A financial statement combines similar accounts to create classifications or groupings with corresponding subtotals. For example, "current assets," "long-term debt," and "operating expenses." In contrast, a trial balance consists of a listing of all general ledger accounts and their corresponding debit or credit balances.
- Presentation Titles - Financial statements usually contain titles that identify the presentation as one intended to present financial position, results of operations, or cash flows. For example, titles such as balance sheet, income statement, and statement of cash receipts and disbursements are used for financial statements. Trial balances usually have (or should have) substantially different titles, such as trial balance, working trial balance, and listing of general ledger accounts.
- Accounting Equation Format - A balance sheet and income statement present financial information according to the fundamental concepts and relationships expressed in the following equations: $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$, and $\text{Revenues} - \text{Expenses} + \text{Gains} - \text{Losses} = \text{Net Income}$. In a true trial balance no attempt is made to present these mathematical or conceptual relationships.
- Net Income Captions - The income statement in a set of financial statements generally contains a caption such as "Net Income" or "Net Revenue Over Expenses" to identify the net results of

operations. Trial balance presentations usually do not contain similar captions.

- **Order of Account Presentation** - A balance sheet usually presents assets in the order of their liquidity and liabilities in order of their maturity. In a trial balance, accounts are generally listed in account number order as they appear in the general ledger.
- **Articulation** - In a set of financial statements, the income statement articulates with the balance sheet because the net results from operations are added to or subtracted from opening retained earnings. In a trial balance, the net results of operations are normally not closed out to retained earnings.

2.113 The accountant must use his or her judgment when deciding whether a presentation is a financial statement or some other type of presentation, such as a trial balance. The judgment should be based on the preponderance of attributes, because the presence of one or two attributes may not be conclusive and, in fact, may create confusion about the nature of the presentation.

Practice Tip:

Accountants should use the above characteristics to avoid producing or submitting presentations that are not clearly either a financial statement or some other type of presentation. If you are uncertain about whether a presentation is or is not a financial statement, use the above characteristics to modify the presentation until the ambiguity is removed. For example, modify titles, account classifications, captions, order of account presentation, etc. until you remove any doubt about the nature of the presentation. Avoid blurred presentations.

What Constitutes Submitting Financial Statements?

2.114 Because SSARS applies when an accountant *submits* unaudited financial statements of a nonpublic entity to his or her client or to others, the meaning of the term *submitting* is important. SSARS No. 1, Interpretation No. 16, *Determining if the Accountant has "Submitted" Financial Statements Even When Not Engaged to Compile or Review Financial Statements*, defines submitting financial statements as presenting to the client or others financial statements that--

- The accountant has generated, either manually or through the use of computer software, or

- The accountant has modified by materially changing account classifications, amounts, or disclosures directly on client-prepared financial statements.

2.115 A clear understanding of submission requires careful consideration of the underscored terms in the above definition. For submission to occur, the accountant must produce the financial statements or make material modifications directly on financial statements that the client has prepared. Any other services involving unaudited financial statements would not constitute submitting financial statements.

2.116 Because submission is restricted to the two conditions cited in paragraph 2.114, a number of services an accountant might typically perform involving unaudited financial statements would not include submitting those financial statements and, therefore, would not be covered by SSARS. Interpretation No. 16 cites the following examples of services that do not involve submission and are not governed by SSARS:

- Reading client-prepared financial statements.
- Proposing correcting journal entries or disclosures to the financial statements, either orally or in written form, that materially change the client-prepared financial statements, as long as the accountant does not directly modify the client-prepared financial statements. This means the accountant may propose written adjustments or modifications on any documents other than the financial statements themselves and not be governed by SSARS.
- Preparing standard monthly journal entries, such as standard entries for depreciation and expiration of prepaid expenses.
- Providing the client with a financial statement format, (e.g., headings, sub-headings, account classification, and account titles) that does not include dollar amounts, to be used by the client to prepare financial statements.
- Advising a client about the selection or use of computer software that the client will use to generate financial statements.
- Providing the client with the use of or access to computer hardware or software that the client will use to generate financial statements.

2.117 **Computer-Generated Financial Statements.** The last item in the above list provides guidance about a persistently troublesome area--computer-generated financial statements. The fundamental consideration in determining whether computer-generated financial statements are covered by SSARS is who generates or produces those statements. It is irrelevant whose software or hardware is used, who enters financial statement data into the software, or who enters adjustments or modifications into the software before the statements are generated.

2.118 Although Interpretation No. 16 removed some of the ambiguity about computer-generated financial statements, one controversial question remains unanswered: What does the term *generated* mean? One school of thought is that the term *generated* means that hardcopy financial statements have been produced. Therefore, financial statements have not been generated unless they have been printed. Accountants who take this view believe that the fundamental guideline in determining whether computer-produced financial statements have been generated is who executes the print command.

2.119 If the accountant executes the print command, then he or she has generated the financial statements and, if they are presented to the client or others, submission has occurred and SSARS applies. If the client executes the print command, then the financial statements are considered to be client-prepared and SSARS does not apply. This would be the case even when the accountant has provided the hardware or software and entered the data, including adjustments, but stops short of *pushing the print button*.

2.120 A second school of thought is that *generated* means financial statements are stored in computer files, even though they have not been printed. Accountants who take this position believe that if the software has completed its processing and financial statements can be retrieved from computer files, then financial statements have been generated. If these computer files are given to the client or others, then the financial statements have been *submitted* to them.

Practice Tip:

The authors believe that practitioners should follow the second school of thought. That is, financial statements have been generated when they exist in computer files, even though they have not been printed. We believe that professionalism is not well served by adopting the view that SSARS does not apply when the accountant enters financial statement data, including adjustments, into the software, executes the processing commands, saves the software product (financial statements) on a floppy disk, and gives the disk to the client who then simply executes the print command. We believe that submitting computer files containing financial statements to a client (or others) constitutes submitting those financial statements and SSARS should apply.

2.121 Draft Financial Statements. Accountants often issue financial statements in draft form to give the client the opportunity to analyze the financial statements prior to putting them in final form. Draft statements are also sometimes issued because all of the information necessary to complete the compilation is not yet available. The question raised is whether this practice is permissible and, if so, under what circumstances.

2.122 SSARS No. 1, Interpretation No. 17, *Submitting Draft Financial Statements*, permits the accountant to issue draft financial statements without a compilation report as long as the accountant intends to submit final financial statements accompanied by the appropriate report. In addition, each page of the draft financial statements must be labeled with language such as *draft*, *preliminary draft*, or *working draft*. It is also appropriate to issue a draft copy of the compilation report for client review. Such a report, however, should also be clearly marked as a draft.

Practice Tip:

If you anticipate issuing draft financial statements, make sure your client is informed early in the engagement about the nature and use of such statements. Particularly, the client should understand that draft statements are not a substitute for statements in final form and that you intend to issue final statements along with the appropriate compilation report. You may also want to include the stipulation that if final financial statements are not issued, the draft financial statements must be returned to you. In the rare circumstance in which draft statements are not followed with final statements and a compilation report, the authors suggest you document the reasons for such a situation in the working papers.

Other Services Where SSARS Do Not Apply

2.123 Other common services involving financial statements sometimes raise questions about whether SSARS apply. These services are discussed below. The accountant, however, should remember the general applicability guideline: SSARS must be followed when an accountant either compiles or reviews historical financial statements of a nonpublic entity.

2.124 **Prospective Financial Statements.** SSARS applies only to historical financial statements. When the accountant provides services on prospective financial statements he or she should consult *Statement on Standards for Accountants' Services on Prospective Financial Information* (AT section 2100 in the *Codification of Statements on Auditing Standards*) and the related audit and accounting guide.

2.125 Elements, Accounts, or Items of a Financial Statement. An accountant may be engaged to compile or review specified elements, accounts, or items of a financial statement. Again, because SSARS applies only to financial statements, these standards are not required to be followed for elements, accounts, or items of a financial statement. If engaged to compile elements, accounts, or items, the accountant may wish to adapt SSARS compilation standards--see Chapter 12, paragraphs 12.106 and 12.107. If engaged to review elements, accounts, or items, the accountant should refer to the Attestation Standards--see Chapter 12, paragraph 12.104.

2.126 Litigation Services. Accountants may provide a variety of services in conjunction with pending or potential litigation or regulatory proceedings. Some of these services may involve submitting historical financial statements. Ordinarily financial statements submitted in connection with litigation services are not subject to SSARS.

2.127 SSARS No. 1, Interpretation No. 20, *Applicability of Statements on Standards for Accounting and Review Services to Litigation Services*, exempts the accountant from following SSARS when historical financial statements are submitted in conjunction with litigation services involving formal legal or regulatory proceedings before a trier of fact in connection with the resolution of a dispute between two or more parties. A trier of fact is a court, regulatory body, or government authority; their agents; a grand jury; or an arbitrator or mediator of the dispute. Specifically, the following accounting services performed in conjunction with litigation or regulatory proceedings are exempt from SSARS:

- Serving as an expert witness
- Serving as the trier of fact or on behalf of a trier of fact
- Performing work that, under the rules of the proceedings, is subject to detailed analysis and challenge by each party to the dispute
- Performing work requested by an attorney that will be protected by the attorney's work product privilege and such work is not intended to be used for other purposes

2.128 SSARS do apply in litigation services when the accountant has been specifically engaged to compile or review financial statements that are the representation of management (owners) in accordance with SSARS. SSARS also apply if the accountant submits financial statements that are the representation of management (owners) to others who under the rules of the proceedings do not have the opportunity to analyze or challenge the accountant's work.

2.129 Personal Financial Statements Included in Written Personal Financial Plans. Under certain circumstances, SSARS No. 6 provides an optional exemption from complying with SSARS No. 1 for personal financial statements. The accountant may submit a written personal financial plan containing unaudited personal financial statements without complying with SSARS No. 1 when all of the following conditions exist:

- A. The accountant establishes an understanding with the client, preferably in writing, that the financial statements--
 - 1. Will be used solely to assist the client and the client's advisors to develop (including implementing) the client's personal financial goals and objectives, and
 - 2. Will not be used to obtain credit or for any purposes other than developing (including implementing) these goals and objectives.
- B. Nothing comes to the accountant's attention during the engagement that would cause the accountant to believe that the financial statements will be used to obtain credit or for any purposes other than developing (including implementing) the client's financial goals and objectives.

2.130 The exemption is optional--the accountant may choose to follow SSARS No. 1 if he or she prefers. When the accountant elects to use the exemption, a special report form, illustrated in SSARS No. 6, must be used instead of the standard compilation report. Chapter 11, page 11-75, includes a sample report on personal financial statements included with a personal financial plan.

2.131 Other Accounting Services. As discussed previously, a compilation, per se, only includes the act of putting information that is the representation of management in financial statement format. Any preceding steps or services the accountant may perform are not included. This means that typing and reproducing client-prepared financial statements (without making material modifications directly on them), bookkeeping and write-up work, accounting advice, adjustment proposals, and other services related to developing or obtaining the information that is to be put into financial statement format are not governed by SSARS.

2.200 REVIEW SERVICES

2.201 SSARS No. 1 created a service that permits an accountant to express limited assurance on the financial statements of a nonpublic entity. That service is a

review service. Paragraph 4 of SSARS No. 1 defines a review service as:

Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with another comprehensive basis of accounting.

2.202 A review differs from a compilation in two principal ways. First, the accountant expresses limited assurance in a review, whereas no assurance is expressed in a compilation. Second, the accountant is required to perform specific types of procedures in a review, inquiries and analytical procedures, to obtain a reasonable basis for expressing that assurance. In a compilation, no specific procedures, other than reading the financial statements, are required.

2.203 As discussed in detail in Chapters 6 and 7, an accountant who reviews financial statements must meet specific performance requirements as well as certain reporting requirements. In general, these requirements are as follows:

- Establish an understanding with the entity regarding the services to be performed and the report the accountant expects to render.
- Have or obtain knowledge of the accounting principles and practices of the entity's industry and an understanding of the entity's business that will provide him or her, through the performance of inquiry and analytical procedures, with a reasonable basis for expressing limited assurance.
- Perform inquiry and analytical procedures sufficient to provide a reasonable basis for expressing limited assurance.
- Perform additional procedures when the accountant becomes aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. These procedures should be sufficient to achieve limited assurance.
- Obtain a representation letter from the owner, manager, or chief executive officer, and, if appropriate, the chief financial officer.
- Consider whether to modify his or her report if in the review of the financial statements the accountant becomes aware of a departure from GAAP (or OCBOA) that is material to the financial statements and the financial statements are not revised.

2.204 Reviews are engagement driven. That is, an accountant is specifically engaged to perform a review and such an engagement causes SSARS to apply. Remember that compilations may be performed either because the accountant was engaged to perform such a service or because the accountant submits unaudited financial statements to his or her client or others. (See paragraphs 2.114 through 2.122 for the criteria for submission.) There are no similar submission criteria for a review. In other words, submission requires a compilation but not a review.

2.205 A financial statement review following SSARS guidance is also permitted for public entities that do not have their annual financial statements audited. Footnote 4 of SAS No. 26, *Association With Financial Statements*, permits such a review of either the interim or annual financial statements of such public entities.

Table 2-1

SUMMARY OF SSARS APPLICABILITY CONSIDERATIONS

<u>Service Performed</u>	<u>Does SSARS Apply?</u>
Engaged to compile or review historical financial statements of a nonpublic entity	YES
Submit unaudited financial statements of a nonpublic entity to client or others	YES--Must compile at a minimum
Submit draft financial statements to client and intend to submit final financial statements	NO--See paragraphs 2.121--2.122
Presentation submitted to client does not meet definition of a financial statement	NO--See paragraphs 2.108--2.113
Accountant's name used in a document containing unaudited financial statements of a nonpublic entity	Must compile or review; or document must include indication that the accountant has not compiled or reviewed and assumes no responsibility
Perform other accounting services, such as: <ul style="list-style-type: none"> • Typing or reproducing client prepared financial statements • Performing bookkeeping or write-up work without submitting financial statements • Reading client-prepared financial statements • Proposing adjustments or disclosures for client-prepared financial statements (not made directly on the financial statements) • Preparing standard monthly journal entries • Provide client with standard financial statement format (providing that amounts are not provided) • Provide client with use of or access to hardware or software to prepare financial statements • Advise client about selection or use of hardware or software that client will use to prepare financial statements 	NO
Submit prospective financial statements to client or others	NO--See paragraph 2.124
Submit compilation of elements, accounts, or items of a financial statement	NO--See paragraph 2.125
Submit financial statements in connection with litigation services	NO--See paragraphs 2.126--2.128
Submit personal financial statements included in a written personal financial plan	OPTIONAL--See paragraphs 2.129--2.130

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CHAPTER 3

ENGAGEMENT MANAGEMENT AND ADMINISTRATION

3.000 ACCEPTANCE AND CONTINUANCE OF CLIENTS

3.001 Because most litigation from accounting and review services arises from claims by the accountant's client rather than an external user, client acceptance and continuance take on particular significance in performing these types of services.

Considerations in Accepting a New Client

3.002 Too often accountants are eager to obtain a new engagement without giving adequate consideration to whether the client is a good prospect. This strategy is usually not consistent with maintaining the accounting firm's profitability and minimizing the possibility of legal disputes.

3.003 The primary consideration in the client acceptance decision is the integrity of management. However, there are other considerations that may affect the desirability of the engagement and the accountant's ability to serve the client's needs. These considerations include--

- Ability to pay fees. An obvious aspect of the acceptance decision is whether the client has the wherewithal to pay the accountant's fees. Small businesses on the brink of failure present many risks and they may offer few rewards. If the client is accepted, the accountant should consider obtaining a fee retainer for performance of the services.
- Ability to service the client. Consideration should be given to the required timing of the services and the need for specialized expertise

in evaluating whether the accounting firm can adequately serve the client's needs. It may not be worth the time required to stay knowledgeable about a complex industry to serve one client in that industry.

- High-risk clients. In addition to the information about the integrity of management, the accountant should also consider the following additional risk factors in deciding whether to accept the client:
 - Certain inclinations of management, such as blaming other parties for problems, overly aggressive tax positions, and unreasonable expectations of what the accountant's services will discover.
 - Poor financial condition
 - Undue reliance by external parties on the financial statements
 - High-risk use of the financial statements, such as for sale of the business, obtaining bonding, or obtaining significant amounts of new debt
 - Other characteristics, such as unusual related party transactions, commingling of business and personal funds, and frequent litigation
- Independence of the accountant. If the accountant is not independent of the client, he or she may not perform a review of the client's financial statements or agreed-upon procedures for the client. While compilation services may be performed for that client, an indication of the lack of independence must be included in the accountant's report.

Determining if the Accountant Lacks Independence

3.004 In determining whether the accountant lacks independence in a compilation or review engagement, the accountant looks to the same authoritative source as in an audit engagement--Rule 101 of the *AICPA Code of Professional Conduct*, and the related Interpretations and Ethics Rulings. Interpretation 101-1 states that the independence of the CPA will be impaired if--

- A. During the period of a professional engagement or at the time of

expressing an opinion, a member or a member's firm--

1. Had or was committed to acquire any direct or material indirect financial interest in the enterprise.
 2. Was a trustee of any trust or executor or administrator of any estate if such trust or estate had or was committed to acquire any direct or material indirect financial interest in the enterprise.
 3. Had any joint, closely held business investment with the enterprise or with any officer, director, or principal stockholders thereof that was material in relation to the member's net worth or to the worth of the member's firm.
 4. Had any loan to or from the enterprise or any officer, director, or principal stockholder of the enterprise except as specifically permitted in Interpretation 101-5.
- B. During the period covered by the financial statements, during the period of the professional engagement, or at the time of expressing an opinion, a member or a member's firm--
1. Was connected with the enterprise as a promoter, underwriter, or voting trustee, a director or officer or in any capacity equivalent to that of a member of management or of an employee.
 2. Was a trustee for any pension or profit-sharing trust of the enterprise.

The above examples are not intended to be all-inclusive.

3.005 Interpretation 101-5 of the *AICPA Code of Professional Conduct* permits the following types of loans from financial institution clients:

- A. Automobile loans and leases collateralized by the automobile.
- B. Loans of the surrender value under terms of an insurance policy.
- C. Borrowings fully collateralized by cash deposits at the same financial institution (e.g., passbook loans).
- D. Credit cards and cash advances on checking accounts with an aggregate balance not paid currently of \$5,000 or less.

E. Loans of the following types that were acquired prior to January 1, 1992 or obtained from a client when independence from the client was not required:

1. Home mortgages.
2. Other secured loans. The collateral on such loans must equal or exceed the remaining balance of the loan at January 1, 1992 and at all times thereafter.
3. Loans not material to the member's net worth.

To qualify for this exception, the loan must be obtained from the financial institution under the institution's normal lending procedures, terms, and requirements.

3.006 Independence of an accountant may also be impaired because of past due fees. Generally, the accountant must have been paid for the prior year's services before issuing the current year's report.

3.007 A question frequently asked in practice is: "Is the accountant's independence impaired by bookkeeping services?" A lack of independence usually does not result from performing bookkeeping services, unless the accountant signs checks, prepares source documents, or performs other management functions, such as consummating transactions, maintaining custody of assets, or acting as an employee of the organization.

Determining the Needs of the Client

3.008 The accountant should discuss the envisioned services with the prospective client, and make sure that the client is clearly informed as to the differences between bookkeeping, compilation, and review services. The prospective client should also understand the limitations of each type of service.

3.009 Usually, the needs of third-party users of the client's financial statements will dictate the level of service (i.e., audit, review or compilation) that is required. However, the accountant can influence the requests of third parties by explaining the nature and extent of assurance provided by each type of service. If a specific third party needs more assurance than is provided by a review of the financial statements, the accountant may recommend that additional agreed-upon procedures be applied to specified financial statement information (see SAS No. 35, *Special Reports--Applying Agreed-Upon Procedures to Specified Elements, Accounts or Items of a Financial Statement*; AU Section 622). These services will be less costly for the client than an audit of the financial statements.

Practice Tip:

If you are engaged to perform both accounting and compilation or review services for a client, it is a good idea to inform the client of the nature of each of these two types of services. Some of the procedures you may need to perform to update and correct the accounting records may appear to the client to be procedures to verify the financial statements. Accordingly, the client may get the impression you are performing a higher level of service than you have been engaged to perform. Also, separating the billing for each service may make it more likely you will collect the fees for the accounting services.

Fee Arrangements

3.010 Fee arrangements are usually set up on a hourly rate or fixed fee basis. However, the *AICPA Code of Professional Conduct* has been recently modified to allow contingent fees or commissions for performing certain types of services for certain clients.

3.011 A CPA is prohibited by the *AICPA Code of Professional Conduct* from accepting contingent fees or commissions from a client for which the CPA also performs one or more of the following services:

- A. An audit or review of a financial statement;
- B. A compilation of a financial statement when the member expects, or reasonably might expect, that a third party will use the financial statement and the member's compilation report does not disclose a lack of independence; or
- C. An examination of prospective financial information.

The CPA is also prohibited from paying a commission for referral of a client for which one or more of the above services are to be performed. If a commission is accepted or paid, the CPA must notify the client.

3.012 Even if the CPA does not perform any of the above services for the client, the *AICPA Code of Professional Conduct* prohibits the acceptance of a contingent fee for the preparation or review of initial or amended tax returns or claim for a tax refund.

3.013 CPAs should also be aware of the provisions of their state accountancy laws regarding the acceptance of such fees, because some state laws are more restrictive than the *AICPA Code of Professional Conduct*.

Practice Tip:

Some CPAs have structured their fee arrangements for personal financial planning to be performed for a fixed fee, but with an offset for any commissions that they obtain from selling products or services to the client. This fee arrangement allows them to perform personal financial planning services on a competitive basis with insurance agents and securities advisors that do not charge a fee for their services. Such arrangements are acceptable, if the CPA does not also perform one of the services described in Section 3.011 for the client.

Sources of Information for Client Acceptance Decisions

3.014 There are various sources an accountant may consider using to obtain information about a prospective client, including--

- Inquiries of client management and employees.
- Review of prior financial statements and tax returns.
- Communications with third parties about the prospective client and its management and principals (e.g., the client's banker, legal counsel, or other individuals in the business community).
- Communications with predecessor accountants

Communications with Predecessor Accountants

3.015 SSARS No. 4 covers communications between successor and predecessor accountants. While SSARS No. 4 does not require the successor accountant to communicate with the predecessor accountant in determining whether to accept an engagement, the Statement indicates that such communications may be desirable when--

- The information about the prospective client is limited or requires special attention,
- a change in accountants occurs substantially after the end of the accounting period for which the financial statements are to be compiled or reviewed, or
- there have been frequent changes in accountants.

3.016 If the successor accountant decides to communicate with the predecessor accountant, the successor accountant should obtain the client's permission and the client should authorize the predecessor to respond fully to the inquiries. If the client refuses to give permission, the successor accountant should consider withdrawing or not accepting the engagement.

3.017 Inquiries about acceptance of the engagement may be made orally or in writing and might include the following:

3.018 SSARS No. 4 obligates the predecessor accountant to respond promptly and fully to communications that might bear on the successor's decision to accept the engagement except in unusual situations, such as those in which the predecessor is in litigation with the client. If the predecessor does not respond fully for such a reason, he or she should state that the response is limited.

3.019 Other inquiries might also be made of the predecessor accountants to facilitate the engagement, including:

- Errors and irregularities, or other inadequacies noted in the client's accounting data
- The necessity to perform other accounting services
- Areas that have required inordinate time in prior periods or where significant adjusting entries were found to be necessary

3.020 The successor may also ask to review the predecessor's working papers and obtain copies of selected working papers. With the client's authorization, the predecessor will normally allow the successor access to working papers, unless there is a valid business reason to prohibit it, such as unpaid fees.

Practice Tip:

Although SSARS No. 4 does not require the successor accountant to communicate with the predecessor accountant about accepting an engagement, it does require the successor accountant to take action in another situation. If the successor accountant becomes aware that financial statements reported on by the predecessor accountant are materially misstated, he or she should request the client to communicate this information to the predecessor accountant. If the client refuses to communicate with the predecessor or if the successor accountant is not satisfied with the predecessor's course of action, the successor would be well advised to consult his or her attorney.

3.100 ENGAGEMENT LETTERS

3.101 SSARS No. 1 requires the accountant to establish an understanding with the client regarding the nature of a compilation or review services engagement. The Statement also indicates that the understanding preferably should be established in writing, i.e., with an engagement letter.

3.102 A good engagement letter helps to prevent misunderstandings between the client and the accountant as to the services to be provided, including the limitations. The engagement letter also sets forth the responsibilities of the client, and in most states it becomes a legally binding contract on both parties. There are other good reasons to obtain an engagement letter, including the following:

- Reduces the risk of litigation. Misunderstandings with clients regarding the nature and limitations of the services provided can result in litigation with the client.
- Avoids misunderstandings by the staff. The staff performing the work can review the engagement letter to obtain a clear understanding of the services to be provided and the required timing of issuance of the report.

Overcoming Client Resistance to an Engagement Letter

3.103 Presenting the engagement letter face-to-face usually is sufficient to overcome any resistance on the part of the client. The AICPA publishes a brochure, titled *The Engagement Letter*, which may be used to explain the purpose of an engagement letter to the client.

3.104 As an alternative to having the client sign an engagement letter, the accountant may consider developing a letter of understanding and mailing it to the client as a confirmation of the oral understanding. If an engagement letter is not obtained, the accountant should prepare a memorandum for the working papers describing the understanding with the client.

How Often Should an Engagement Letter be Obtained?

3.105 Some firms have a policy of obtaining a new engagement letter annually. Others use an automatically renewing (evergreen) letter that is only updated when the services to be provided change or there is a significant change in management or

ownership of the client. Another possibility is the use of a general service agreement with separate addendums to the agreement, issued periodically, to describe the services to be provided.

The Content of Engagement Letters

3.106 The engagement letter should be tailored to the engagement, after the specific services have been agreed upon. A comprehensive engagement letter might include the following:

- A description of the nature of the services to be performed.
- A description of the client or entities involved.
- The period covered by the financial statements to which the accountant's report will relate.
- A description of the nature of the report.
- A statement of the limitations of the service in detecting errors, irregularities and illegal acts, with an indication that the accountant will inform the client of any such matters coming to his or her attention.
- An indication of what will happen if the accountant is unable to complete the engagement.
- If applicable, a statement that management will be requested to sign a representation letter.
- A description of any other services to be performed.

Practice Tip:

Be careful when using a proposal or preliminary engagement letter for a client. If the letter describes additional services that are not finally agreed upon, it may be used in litigation as an indication of inadequate performance by you on the engagement. You should also make sure that a final engagement letter is always issued in such circumstances.

Using Engagement Letters to Minimize Liability to Third Parties

3.107 The AICPA's task force on accountant's legal liability developed guidance on using engagement letters to minimize liability to third parties. The task force concluded that clarifying language added to an engagement letter may be useful in states in which the courts adhere to the privity concept of liability to third parties. This clarifying language should identify third parties that are known by the accountant to be negotiating or contemplating a transaction with the client, and who will be obtaining a copy of the compiled or reviewed financial statements. An example of such language is as follows:

We understand that you are negotiating with XYZ Bank for a loan in the amount of \$25,000 and the purpose of our report on your financial statements is to enable you to present the (compiled) (reviewed) financial statements to XYZ Bank. We are not aware of any other persons, entities or limited groups of persons or entities for whose use or benefit this report is intended or contemplated.

Practice Tip:

In the authors' opinion, the clarifying language in paragraph 3.107 added to an engagement letter is of questionable effectiveness in minimizing legal liability. However, if you decide to use it, you should consult with legal counsel to get advice on the specific wording that may be effective for your particular state.

3.108 A more effective way of minimizing legal liability may be use of a separate privity letter. A privity letter allows the accountant to--

- Name a third party that has informed the accountant that it intends to rely on the financial statements.
- Address the third party's responsibilities to undertake an investigation and due diligence review of the financial statements and condition of the company or to retain other professionals to assist it in that effort.
- Make it clear that you do not expect the third party to rely solely on your report on the financial statements as the basis for its decision.
- Contrast the scope of the work and level of assurance provided with the level of assurance and scope of an audit.

3.109 An accountant, contemplating use of a privity letter, should consult with legal counsel regarding its effectiveness in minimizing legal liability in the accountant's particular state. Because legal requirements vary from state to state, the accountant should also consult with legal counsel regarding the appropriate content of the letter.

3.200 OBTAINING AN UNDERSTANDING OF THE CLIENT'S BUSINESS AND INDUSTRY

3.201 To perform a compilation or a review of financial statements, the accountant must have a sufficient understanding of the client's business and industry to perform the particular service. Although the accountant is not required to have this knowledge when the engagement is accepted, the knowledge must be obtained by the time the engagement is completed.

3.202 To perform a compilation of financial statements, the accountant should have a level of knowledge of the accounting principles and practices of the client's industry that is sufficient to enable the accountant to compile the financial statements in the appropriate form.

3.203 The accountant's knowledge of the client's business should include an understanding of the--

- Nature of the client's business transactions, i.e., the client's sources of revenues and types of expenditures.
- Form of its accounting records, i.e., the nature of the client's journals and subsidiary and general ledgers.
- Stated qualifications of its accounting personnel, i.e., the experience, training and education of the personnel maintaining the accounting records.
- Accounting basis on which the financial statements are to be presented, i.e., whether the financial statements are to be prepared on the basis of generally accepted accounting principles or some other comprehensive basis of accounting, such as the basis used to file the client's tax return.
- Form and content of the financial statements, i.e., the basis of presentation of the assets, liabilities, revenues and expenses and required financial statement disclosures.

3.204 To perform a review of financial statements, the accountant should possess a level of knowledge of the accounting principles and practices of the client's industry and an understanding of the client's business, that is sufficient to design appropriate inquiries and analytical procedures and interpret their results. The accountant's understanding of the client's business should include a general understanding of the--

- Client's organization, i.e., the duties and responsibilities of the officers and principal employees of the client.
- Operating characteristics, i.e., a general knowledge of the client's production, distribution, and compensation methods, type of products and services, operating locations, and material transactions with related parties.
- Nature of the client's assets, liabilities, revenues, and expenses.

Sources of Information About the Client's Business and Industry

3.205 The accountant may obtain the required information about the client's business and industry from a variety of sources, including--

- Experience with the client
- Experience with clients in the same industry
- Inquiry of client personnel
- Review of financial statements of entities in the same business
- Consulting AICPA guides, industry publications, textbooks and periodicals
- Consulting with individuals knowledgeable about the client's industry

3.300 CHANGES IN ORIGINAL ENGAGEMENT SERVICE

3.301 For various reasons, a client may request a change in the initial type of service the accountant was engaged to perform. Generally, changes may be made among the following four services: audit, review, compilation with full disclosure, and compilation that omits substantially all disclosures. Changes may be made in

either direction--to a higher level of service or to a lower level of service.

Changes to a Higher Level of Service

3.302 Professional standards do not provide guidance concerning changes from a lower level of service to a higher level. The principal issues when considering such changes are (1) whether the service can be provided, and (2) that the professional standards governing the higher level of service are followed. Therefore, in considering changes to a higher level of service, the accountant should consult the professional standards for that service in light of any information he or she may have obtained from performing the initial service level.

Changes to a Lower Level of Service

3.303 SSARS No. 1 contains specific guidance for changes to a lower level of service. Whenever a client requests a lower level of service after an engagement has begun, the accountant should consider the reason for the request. As discussed in the following paragraphs, the client's reason for requesting a lower level may be justified, or it might result from the client's attempt to restrict the accountant's work, in which case, the accountant may not wish to perform the lower-level service. Paragraph 44 of SSARS No. 1 provides guidance for deciding whether the client's reasons for requesting a lower service level are reasonable. The three major reasons are described below:

- A change in circumstances affecting the entity's requirement for the original service.
- A misunderstanding by the entity's management as to the nature of the services available.
- A restriction on the scope of the original service.

3.304 Change in Requirements. An entity may engage the accountant to provide a particular service because other parties require it. In some circumstances, the requirements for the original service may change. For example, a bank may change its requirement for an audit and decide to accept a review when the requested loan amount decreases. Generally, when a change in requirements is the reason for requesting a lower level of service, the accountant should agree to provide the lower level. When the change is from an audit to any other lower level of service, however, the accountant should also consider the additional audit effort and cost necessary to complete the audit.

3.305 Misunderstanding of Services Available. Sometimes a client may not fully understand the four basic services identified in paragraph 3.301. If the client later becomes aware of alternative services, he or she may find a lower level of service better suited to his or her needs and request a change to that service. Ordinarily, this is an acceptable reason for providing the lower level of service. When the change is from an audit to any other lower level of service, however, the accountant should also consider the additional audit effort and cost necessary to complete the audit.

Practice Tip:

Discussing with your client the types of services available and carefully considering client needs before the client selects a specific service can greatly reduce the likelihood of client misunderstanding about available services. Such misunderstandings can cause both client relation and fee problems. For example, if significant audit work has been performed prior to the client's request to change to a review or compilation you may either lose billable time or incur client ill-will if you bill for that audit work. Make sure your client understands the range of services available, and carefully consider your client's needs and assist the client in selecting the appropriate service.

3.306 Restriction on Scope of Original Service. Restrictions can occur when the client limits the scope of either an audit or review. In addition, a client may request a change from a compilation with full disclosure to one that omits substantially all disclosures to avoid disclosing certain information. When the accountant is not permitted to perform work or make disclosures he or she considers necessary for a particular level of service, changing to a lower level of service is risky. The risk arises because these restrictions may relate to information that is incorrect, incomplete, or otherwise unsatisfactory. By stepping down to the lower level of service, the accountant may not become aware of the problem.

3.307 The following two specific scope restrictions discussed in paragraph 47 of SSARS No. 1 ordinarily preclude the accountant from accepting a change from an audit to a review or compilation:

- The client prohibits the accountant from communicating with the entity's legal counsel.
- The client refuses to sign a representation letter.

Practice Tip:

Generally, the accountant should not accept requests for changes to a lower level of service arising from scope restrictions. Scope restrictions limit the accountant's knowledge about certain financial statement items that will carry over to the lower service. The risk associated with a scope restriction is not mitigated by changing to a lower level of service which does not require the specific procedure(s) that are the subject of the scope limitation.

3.308 Paragraph 19 of SSARS No. 1 permits the accountant to compile financial statements that omit substantially all disclosures provided that to the accountant's knowledge such omission is not undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. Therefore, in accepting a request to change from a full-disclosure compilation to one that omits substantially all disclosures, the accountant should carefully consider the reasons for such a request.

Practice Tip:

Either a change in requirements or a misunderstanding about services available is ordinarily an acceptable reason for changing from a compilation of financial statements with full disclosures to a compilation of financial statements that omit substantially all disclosures. If you believe neither of these reasons exist, you should probably decline to change to the lower level of service.

3.400 QUALITY CONTROL REQUIREMENTS AND CONSIDERATIONS

3.401 In 1988, the membership of the AICPA voted to adopt the *Plan to Restructure Professional Standards*. One requirement of that Plan is that all members of the AICPA that are in public practice must practice with a firm that participates in a quality or peer review program. These firms must have a review of their quality control systems at least every three years.

What Is a System of Quality Control?

3.402 *Statement on Quality Control Standards* (SQCS) No. 1 requires a CPA firm to establish a system of quality control that provides reasonable assurance that the firm will conform with professional standards. In developing this system, the firm considers each of the elements of quality control described below, to the extent

applicable to the firm's practice:

- **Independence.** Policies and procedures to help assure that personnel maintain independence as required by the *AICPA Code of Professional Conduct*. (See paragraphs 3.004 through 3.007.)
- **Assigning Personnel to Engagements.** Policies and procedures to help assure that personnel performing the work have adequate training and proficiency. In making assignments, the nature and extent of the supervision to be provided should be taken into account.
- **Consultation.** Policies and procedures to help assure that personnel will seek assistance, to the extent needed, from persons having appropriate levels of knowledge, competence, judgment and authority.
- **Supervision.** Policies and procedures for the conduct and supervision of the work to help assure that the work performed meets the firm's standards of quality.
- **Hiring.** Policies and procedures to help assure that those employed by the firm possess the appropriate characteristics to enable them to perform competently.
- **Professional development.** Policies and procedures to help assure that firm personnel will have the knowledge required to enable them to fulfill responsibilities assigned to them.
- **Advancement.** Policies and procedures to help assure that personnel selected for advancement are qualified. Qualifications that should be considered include, among others, character, intelligence, judgment, and motivation.
- **Acceptance and continuance of clients.** Policies and procedures for deciding whether to accept or continue an association with a client in order to minimize the likelihood of association with a client whose management lacks integrity.
- **Inspection.** Policies and procedures to help assure that the policies and procedures for the other elements of quality control are being effectively applied.

What Is Peer Review?

3.403 An independent peer review every three years is a membership requirement of both sections, the SEC Practice Section (SECPS) and the Private Companies Practice Section (PCPS), of the AICPA Division for Firms. While all firms that are members of the SECPS are required to have an on-site peer review, a PCPS member firm that does not perform audits of financial statements or examinations of prospective financial statements may have, instead, a report peer review. The differences between these two types of reviews are described below:

- On-site peer review. In an on-site review the peer reviewers visit the CPA firm's offices to perform procedures to test compliance with the firm's quality control system.
- Report (off-site) peer review. In a report review the CPA firm is requested to provide selected compilation and review reports and related financial statements. The peer reviewer will review the reports and financial statements for compliance with the appropriate standards, but will not review the working papers or the CPA firm's system of quality control.

What Is the Quality Review Program?

3.404 CPA firms that are not members of the Division for CPA Firms may participate in the AICPA's quality review program. The requirements of this program, as set forth in *Standards for Performing and Reporting on Quality Reviews*, are similar to those of the PCPS. A CPA firm that does not perform audits of financial statements or examinations of prospective financial statements may arrange for a report (off-site) review, as described above. Other CPA firms must have an on-site quality review.

Common Deficiencies Encountered in Quality Reviews

3.405 The most common deficiencies related to compilation and review engagements that were encountered in the early years of the quality review program include:

- Inadequate continuing professional education courses in accounting areas

- **Failure to use an engagement letter or document the understanding with the client**
- **Inadequate documentation of analytical procedures and related investigation of significant fluctuations**
- **Deficiencies noted in financial statements and reports, generally because disclosure and reporting checklists were not used**
- **Failure to complete work programs**
- **Failure to disclose the lack of independence in compilation reports**
- **Failure to disclose the other comprehensive basis of accounting used in compilation reports on financial statements that omit substantially all disclosures**

3.500 Documentation Assistance

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Client Acceptance Form--Part I

Client: _____

Date: _____

INSTRUCTIONS:

This form should be completed for all prospective clients for which compilation or review services are to be performed. The data on the form should be reviewed as a basis for initially accepting the client. The form should be updated and reviewed annually as a basis for maintaining an understanding of the client and making decisions about retaining the client.

PART I--BACKGROUND INFORMATION

CLIENT'S LEGAL NAME: _____

ADDRESS: _____

PHONE: _____

FEDERAL I.D. NO.: _____

STATE I.D. NO.: _____

1. Describe the nature of the client's business:

2. Identify the type of entity (e.g., proprietorship, partnership, regular corporation, S Corporation, or nonprofit): _____

3. List key owners, officers, and directors of the client:

Name	% Owned	Position

4. Identify any related businesses or individuals:

Name	Nature of Relationship

5. Identify the client's predecessor accountants:

Name:
Address:
Contact person:

6. Did we decide to contact the predecessor accountants? _____

If so, list their comments:

7. Describe the client's relationships with financial institutions:

Name	Type of A/Cs or Loans	Account Executive

8. Describe the services to be provided:

Service	How Often?			Report Deadlines
	Monthly	Quarterly	Annually	

Other Services:

Federal Tax Returns _____
 State Tax Returns _____
 Payroll Tax Returns _____

 Tax returns for principal owners _____
 Which ones? _____

9. Will the financial statements and reports be used for high-risk purposes, e.g., to obtain significant amounts of new credit, to obtain performance bonding, or for purchase of the business? _____

Describe use of the financial statements:

10. Does the client have potential going-concern problems? _____

If so, describe them:

11. Describe the client's major sources of financing:

12. Describe any significant engagement performance, accounting or tax problems with which we should be concerned:

13. Describe the billing arrangements:

14. Describe any potential independence problems with respect to the client:

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or Updated by: _____

Reviewed by: (Partner) _____

Client Acceptance Form--Part II

Client: _____

Date: _____

- | | <u>Yes</u> | <u>No</u> |
|---|--------------------------|--------------------------|
| 1. Is there any reason to doubt the integrity of management (owners)? | <input type="checkbox"/> | <input type="checkbox"/> |
| 2. Are we aware of any significant disagreements between management (owners) and the predecessor accountant? | <input type="checkbox"/> | <input type="checkbox"/> |
| 3. Does there appear to be any potential fee collection problems? | <input type="checkbox"/> | <input type="checkbox"/> |
| 4. Are the client's needs beyond our capabilities or staffing abilities? | <input type="checkbox"/> | <input type="checkbox"/> |
| 5. Are we aware of any independence problems that may affect our ability to meet the client's needs? | <input type="checkbox"/> | <input type="checkbox"/> |
| 6. Are there high-risk factors related to the engagement that may affect our decision to accept the client? | <input type="checkbox"/> | <input type="checkbox"/> |
| 7. Is there a potential problem with management (owners) not fully understanding the limitations of the services to be provided (e.g., for the detection of fraud)? | <input type="checkbox"/> | <input type="checkbox"/> |

For any "Yes" answers, explain how we plan to mitigate the problem (for example, by assigning more experienced personnel to the engagement, obtaining outside consultants, obtaining a retainer from the client, etc.):

Acceptance Decision:

Yes _____ No _____

Engagement Partner: _____ Date: _____

Concurring Partner: _____ Date: _____

Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements

Client:

Date:

INSTRUCTIONS:

This form should be completed for all compilation and review engagements (other than for personal financial statements). When used in conjunction with the *Client Acceptance Form*, the form provides documentation of the required understanding of the client's business and industry. It should be reviewed and updated annually for any changes in the client's business.

I. INDUSTRY INFORMATION

A. Describe major types of products or services provided by the client:

	% of Volume

B. Describe any sources of information about the client's accounting principles (e.g., AICPA guides, industry publications):

II. ACCOUNTING PRINCIPLES

A. What is the basis of accounting to be used for the financial statements both on an annual and interim basis [GAAP or Other Comprehensive Basis of Accounting (OCBOA)]?

1. Annual financial statements:

2. Interim financial statements:

B. Describe the client's significant accounting policies:

III. ACCOUNTING RECORDS

A. What is the form of the client's accounting records?

<u>Record</u>	<u>Form of the Records</u>		<u>Personnel Responsible</u>
	<u>Manual</u>	<u>Computer</u>	
Journals:			
Cash receipts	M	C	_____
Cash disbursements	M	C	_____
Sales	M	C	_____
Purchases/Voucher	M	C	_____
Payroll	M	C	_____
General	M	C	_____
_____	M	C	_____
_____	M	C	_____
Ledgers:			
General	M	C	_____
Accounts Receivable	M	C	_____
Accounts payable	M	C	_____
Perpetual Inventory	M	C	_____
Physical Inventory Schedule	M	C	_____
_____	M	C	_____
_____	M	C	_____

- B. If the client uses accrual basis accounting, describe the client's procedures, if any, for achieving an adequate cut-off of transactions when the financial statements are prepared.

- C. If applicable, describe the client's procedures for taking a physical count of its inventory. State how often it is taken.

IV. STATED QUALIFICATIONS OF ACCOUNTING PERSONNEL

<u>Name</u>	<u>Responsibilities</u>	<u>Qualifications</u>

V. OTHER INFORMATION

- A. Is there economic dependency on a major customer? _____ If so, describe customer and percent of sales.

- B. Describe the nature of any stock plans (e.g., stock options, repurchase, etc.).

C. Describe any transactions with related parties, including the nature of the relationship.

D. Describe any other information that is significant to the engagement.

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or
Updated by:

Reviewed by:
(Partner)

Form for Documenting Understanding of Client's Business and Industry--Supplement for Review Engagement

Client:

Date:

INSTRUCTIONS:

This form should be completed for all review engagements (other than reviews of personal financial statements). When used in conjunction with the *Client Acceptance Form* and the *Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements*, this form provides documentation of the additional required understanding of the client's business and industry required for review engagements. It should be reviewed and updated annually for any changes in the client's business.

I. ORGANIZATION AND PERSONNEL

A. Identify and describe the responsibilities of the chief officers.

Name

Responsibilities

<u>Name</u>	<u>Responsibilities</u>

B. Describe the locations at which the client does business and the nature of the activity and number of employees at each location.

C. Describe briefly the compensation methods for each class of employees.

II. OPERATING CHARACTERISTICS

A. Describe the company's sources of revenue, marketing, and distribution methods.

B. Describe the nature of the client's significant assets and liabilities.

C. Describe the nature of the client's significant expenses.

D. Describe the client's production process.

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or
Updated by:

Reviewed by:
(Partner)

**EXAMPLE MEMORANDUM FOR WORKING PAPERS TO
DOCUMENT THE UNDERSTANDING WITH THE CLIENT**

I have discussed the nature of my (our) engagement with _____, owner of _____ [Client Name], and have established the following understanding:

- I (We) will compile the client's annual financial statements for the year ended _____ [Financial Statement Date] in accordance with the tax basis of accounting with full disclosure.
- I (We) will compile the client's monthly financial statements for the _____ year in accordance with the tax basis of accounting, omitting substantially all required disclosures.
- I (We) will prepare the federal and state of _____ [State] income tax returns for the client for the fiscal year ended _____.
- My (Our) fees for these services

Engagement Letter--Compilation Engagement

[Date]

Dear _____:

This letter is to confirm my (our) understanding of the terms and objectives of my (our) engagement and the nature and limitations of the services I (we) will provide.

I (We) will perform the following services:

1. I (We) will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and cash flows of _____ [Client Name] for the year 19___. I (We) will not audit or review such financial statements. My (Our) report on the annual financial statements of _____ [Client Name] is presently expected to read as follows:

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established 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 (owners). I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

My (Our) report on your interim financial statements, which will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting

principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, I am (we are) unable to complete the compilation of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

2. I (We) will assist your bookkeeper in adjusting the books of account so that he or she will be able to prepare a working trial balance from which financial statements can be compiled. Your bookkeeper will provide me (us) with a detailed trial balance and any supporting schedules I (we) require.
3. I (We) will also prepare the federal and _____[State] income tax returns for _____[Client Name] for the fiscal year ended _____.

My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of irregularities that come to my (our) attention, unless they are clearly inconsequential.

My (Our) fees for these services....

I (We) shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely yours,

Acknowledged:

Title

Date

Engagement Letter--Review Engagement

[Date]

Dear _____:

This letter is to confirm my (our) understanding of the terms and objectives of my (our) engagement and the nature and limitations of the services I (we) will provide.

I (We) will perform the following services:

1. I (We) will review the balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. My (Our) review will consist primarily of inquiries of company personnel and analytical procedures (and I (we) will require a client representation letter from you). A review does not contemplate obtaining an understanding of the internal control structure or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that I (we) will become aware of all significant matters that would be disclosed in an audit. My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of any such matters that come to my (our) attention, unless they are clearly inconsequential. I (We) will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and accordingly, I (we) will not express such an opinion on them.

My (Our) report is presently expected to read as follows:

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information

included in these financial statements is the representation of the management of _____ [Client Name].

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, I am (we are) unable to complete my (our) review of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

2. I (We) will provide your bookkeeper with such consultation on accounting matters as he or she may be required in adjusting and closing the books of account and in drafting financial statements for my (our) review. Your bookkeeper also will provide me (us) with a detailed trial balance and any supporting schedules I (we) require.

My (Our) fees for these services....

I (We) shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely yours,

Acknowledged:

Title

Date

CLIENT SERVICE AGREEMENT

[Date]

Dear _____:

I am (We are) pleased that you have selected my (our) firm to provide professional accounting services. This agreement contains the general terms of the nature of these services. The specific details will be confirmed by separate letters.

When requested, I (we) will provide a fee estimate, which may be subject to change as the work progresses. My (Our) fees currently range from \$___-\$___ per hour and are subject to periodic revision. The hourly rate is determined by the experience of the staff working on your account. In addition to hourly charges, I (we) will invoice you for any direct costs incurred on your behalf.

Invoices will be due and payable in full monthly, unless I (we) make other specific written arrangements with you. Amounts past due will be assessed a late charge of ___ percent monthly.

I (We) reserve the right to resign from the engagement at any time and for any reason, including if you do not make the payments required by this agreement or if you have misrepresented or failed to disclose material information to me (us).

You also retain the right to terminate this agreement at any time and for any reason, in which case I (we) ask to be so advised in writing. In either event, you would be responsible for the fees and costs to date of notification of termination.

Should I (we) refer your account to an attorney for the collection of past due invoices, I (we) will be entitled to recover attorneys' fees.

No change, waiver or modification of any of the provisions of this agreement shall be effective unless in writing and signed by my (our) firm. I (We) have made no representations or promises other than those expressly set forth in this agreement.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely,

Acknowledged:

Title

Date

Addendum to Client Service Agreement--Compilation Engagement

[Date]

Re: Confirmation of Services

Dear _____:

This letter confirms the following services, under the general terms of my (our) Client Service Agreement.

Compilation Services: I (We) will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and cash flows of _____ [Client Name] for the year 19___. I (We) will not audit or review such financial statements. My (Our) report on the annual financial statements of _____ [Client Name] is presently expected to read as follows:

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established 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 (owners). I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

My (Our) report on your interim financial statements, which will omit substantially all disclosures, will include the following additional paragraph:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted

disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, I am (we are) unable to complete the compilation of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of any such matters that come to my (our) attention, unless they are clearly inconsequential.

These services do not include accounting and bookkeeping assistance that may be needed to complete my (our) compilation. However, I (we) will be pleased to provide this assistance at an additional fee.

Fee: My (Our) estimated fee to compile your financial statements is

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely,

Acknowledged:

Title

Date

Addendum to Client Service Agreement--Review Engagement

[Date]

Re: Confirmation of Services

Dear _____:

This letter confirms the following services, under the general terms of my (our) Client Service Agreement.

Review Services: I (We) will review the balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. My (Our) review will consist primarily of inquiries of company personnel and analytical procedures (and I (we) will require a client representation letter from you). A review does not contemplate obtaining an understanding of the internal control structure or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that I (we) will become aware of all significant matters that would be disclosed in an audit. My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of any such matters that come to my (our) attention, unless they are clearly inconsequential. I (We) will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and accordingly, I (we) will not express such an opinion on them.

My (Our) report is presently expected to read as follows:

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of _____ [Client Name].

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, I am (we are) unable to complete the review of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

At the conclusion of my (our) review, I (we) will request that you provide me (us) with certain written representations about the statements and related matters. A sample of this letter is enclosed.

These services do not include accounting and bookkeeping assistance that may be needed to complete my (our) review. However, I (we) will be pleased to provide this assistance at an additional fee.

Fee: My (Our) estimated fee to review your financial statements is

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely,

Acknowledged:

Title

Date

CHAPTER 4
PERFORMING FINANCIAL STATEMENT COMPILATION ENGAGEMENTS

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CHAPTER 4
PERFORMING FINANCIAL STATEMENT COMPILATION ENGAGEMENTS

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CHAPTER 4

PERFORMING FINANCIAL STATEMENT COMPILATION ENGAGEMENTS

4.000 WHAT IS A COMPILATION?

4.001 A compilation of financial statements is defined by SSARS No. 1 as "presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements." SSARS No. 1 clearly states that performing a compilation, does not include making inquiries or performing other procedures to verify, corroborate, or review the information supplied by the client. Likewise, the accountant does not have to obtain an understanding of the client's internal control structure or assess control risk. This does not mean that the accountant can compile financial statements that are known to be misleading. If the accountant becomes aware that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory, he or she should obtain additional or revised information. If the client refuses to provide additional or revised information, the accountant should withdraw from the engagement.

What Are the Requirements of a Compilation?

4.002 SSARS No. 1 includes several performance requirements for a compilation of financial statements, including the following:

- Establish an understanding with the client, preferably in writing, regarding the services to be performed. (See section 3.100 of Chapter 3.)
- Possess or obtain a level of knowledge of the accounting principles and practices of the industry in which the client operates. (See section 3.200 of Chapter 3.)

- Possess or obtain a general understanding of the nature of the client's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, and the accounting basis and form and content of the financial statements. (See section 3.200 of Chapter 3.)
- Consider whether it is necessary to perform other accounting services to be able to compile the financial statements.
- Request additional or revised information when the information provided by the client appears to be incorrect, incomplete, or otherwise unsatisfactory.
- Read the compiled financial statements and consider whether they appear to be appropriate in form and free from obvious material misstatements.

A flowchart for performing compilation engagements is set forth in Table 4-1.

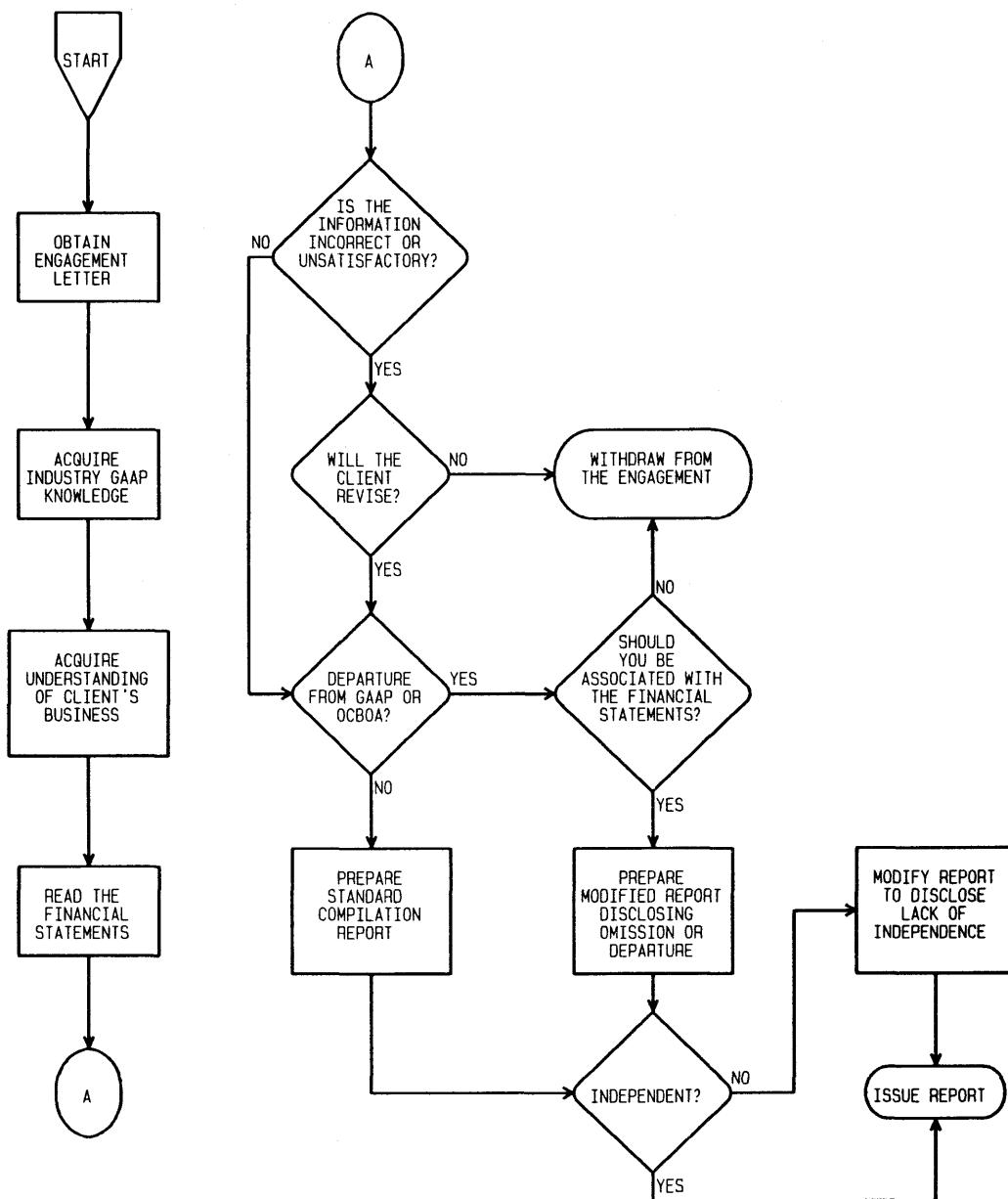
4.003 The first three of these requirements are described in Chapter 3; the others are discussed in the remaining portion of this chapter.

4.004 Consider the Need to Perform Other Accounting Services. The accountant should never compile financial statements from accounting records that are likely to be materially incorrect or incomplete because the client's personnel have not or cannot maintain appropriate records. Therefore, based on his or her knowledge of the client, the accountant may find it necessary to arrange to perform additional services to update or adjust the client's accounting records before compiling the financial statements.

4.005 Request Additional or Revised Information. Although the accountant is not required to perform any procedures to verify information supplied by the client, he or she may become aware that information provided is incorrect, incomplete, or otherwise unsatisfactory. In such circumstances, the accountant should obtain additional or revised information. If the client refuses to provide additional or revised information, the accountant should withdraw from the compilation engagement. This requirement does not apply to information that is not needed because management has elected to omit substantially all of the disclosures required by generally accepted accounting principles.

Table 4-1

FLOWCHART FOR PERFORMING COMPILATION SERVICES



4.006 Read the Compiled Financial Statements. The required reading of the financial statements is designed to bring the accountant's knowledge of industry accounting principles and the client's business to bear on the financial statement presentation. In reading the financial statements, the accountant should be alert for arithmetical or clerical errors and mistakes in the application of accounting principles, including inadequate disclosure.

4.100 OTHER PROFESSIONAL STANDARDS AND REQUIREMENTS

AICPA Code of Professional Conduct

4.101 All services provided by the accountant are governed by Rule 201--General Standards of the *AICPA Code of Professional Conduct*. This rule includes the following requirements:

- **Professional Competence.** Undertake only those professional services that the accountant can reasonably expect to be completed with professional competence.
- **Due Professional Care.** Exercise due professional care in the performance of professional services.
- **Planning and Supervision.** Adequately plan and supervise the performance of professional services.
- **Sufficient Relevant Data.** Obtain sufficient relevant data to afford a reasonable basis for the conclusions or recommendations in relation to any professional services performed.

4.102 The *Statements on Standards for Accounting and Review Services* provide interpretive guidance for the accountant in complying with the requirements of Rule 201. By complying with the requirements of SSARS, the accountant will comply with the requirements of Rule 201.

Quality Control Standards

4.103 As discussed in section 3.400 of Chapter 3, *Statement on Quality Control Standards No. 1* applies to compilation engagements. To the extent applicable, the accountant should establish policies and procedures related to the nine elements of quality control. Policies requiring the use of standardized forms and checklists for compilation services (such as those illustrated in this manual) help insure that the firm complies with quality control requirements.

4.200 DOCUMENTATION OF COMPILATION ENGAGEMENTS

4.201 The following pages include illustrative forms and checklists for compilation engagements. The Client Acceptance Form (page 4-12) and the Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements (page 4-17) are discussed in Chapter 3. The forms are repeated in this chapter to facilitate reproduction of a documentation package for a compilation engagement.

Computerized Accounting Processing

4.202 The Computerized Accounting Processing Form (page 4-10) is designed to control the processing of the client's data and the preparation of the adjusted trial balance and financial statements for a compilation or a review engagement.

The Work Program

4.203 The Compilation Engagement Work Program (page 4-21) is designed to document the planning and performance of the engagement.

Technical Review Checklist

4.204 The Technical Review Checklist (page 4-25) is designed for CPA firms that require technical review of compilation engagements to assess the adequacy of the financial statement presentation and disclosure. Such reviews are typically performed by an accountant that was not involved with the engagement.

Signer's Checklist

4.205 The Signer's Checklist (page 4-26) is designed to be completed by the engagement partner to document appropriate performance of the engagement. It also serves to authorize the release of the financial statements and the report.

Financial Statement Control Form

4.206 The Financial Statement Control Form (page 4-27) aids in routing the financial statements and the report through the administrative process. It provides for overall control of the engagement.

Suggested Working Papers

4.207 Table 4-2 illustrates suggested working papers for documentation of a compilation engagement.

Table 4-2

Suggested Working Papers for Compilation Engagement

<u>Description</u>	<u>Page</u>
Engagement Letter or Memorandum Describing Understanding With the Client	4-8
Computerized Accounting Processing Form	4-10
Client Acceptance Form	4-12
Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements	4-17
Compilation Engagement Work Program	4-21
Technical Review Checklist (If Required by Firm Policy)	4-25
Signer's Checklist	4-26
Financial Statement Disclosure Checklist (If Statements Do Not Omit Disclosures)	13-38
Financial Statement Control Form	4-27
Trial Balance	
Adjusting and Reclassification Entries	
Documentation of Any Other Procedures Performed or Other Special Circumstances (e.g., Step-Down to a Lower Level of Service)	

4.300 Documentation Assistance

<u>Description</u>	<u>Page</u>
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Signer's Checklist--Compilation and Review Engagements	4-26
Financial Statement Control Form	4-27

Engagement Letter--Compilation Engagement

[Date]

Dear _____:

This letter is to confirm my (our) understanding of the terms and objectives of my (our) engagement and the nature and limitations of the services I (we) will provide.

I (We) will perform the following services:

1. I (We) will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and cash flows of _____ [Client Name] for the year 19___. I (We) will not audit or review such financial statements. My (Our) report on the annual financial statements of _____ [Client Name] is presently expected to read as follows:

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established 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 (owners). I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

My (Our) report on your interim financial statements, which will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting

principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, I am (we are) unable to complete the compilation of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

2. I (We) will assist your bookkeeper in adjusting the books of account so that he or she will be able to prepare a working trial balance from which financial statements can be compiled. Your bookkeeper will provide me (us) with a detailed trial balance and any supporting schedules I (we) require.
3. I (We) will also prepare the federal and _____ [State] income tax returns for _____ [Client Name] for the fiscal year ended _____.

My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of irregularities that come to my (our) attention, unless they are clearly inconsequential.

My (Our) fees for these services....

I (We) shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely yours,

Acknowledged:

Title

Date

Computerized Accounting Processing Form

Client: _____

- Annual Financial Statements
 Interim Financial Statements

Financial Statement Date: _____

INSTRUCTIONS:

The following is a general guide for processing accounting records when this service is performed for a client in conjunction with the compilation or review engagement.

<u>PREPARER'S PROCEDURES</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Review the client data for : a. completeness. b. accuracy of coding. c. form and content.	_____	_____	<input type="checkbox"/>
2. Reconcile or review reconciliation of all cash accounts.	_____	_____	<input type="checkbox"/>
3. Prepare recurring adjusting entries.	_____	_____	<input type="checkbox"/>
4. Enter cash receipts.	_____	_____	<input type="checkbox"/>
5. Enter cash disbursements.	_____	_____	<input type="checkbox"/>
6. Enter sales transactions.	_____	_____	<input type="checkbox"/>
7. Enter purchase transactions.	_____	_____	<input type="checkbox"/>
8. Post batches.	_____	_____	<input type="checkbox"/>
9. Run trial balance.	_____	_____	<input type="checkbox"/>
10. Review trial balance and other output for completeness and reasonableness.	_____	_____	<input type="checkbox"/>
11. Rerun trial balance.	_____	_____	<input type="checkbox"/>
12. Print financial statements, general ledger, and journals.	_____	_____	<input type="checkbox"/>
13. Compare the current-period financial statements to any comparative statements for prior periods for reasonableness.	_____	_____	<input type="checkbox"/>
14. Back-up client data files.	_____	_____	<input type="checkbox"/>

REVIEWER'S PROCEDURES

PERFORMED BY
Initials Date

N/A

- 1. Using the trial balance and the financial statements, review the supporting working papers to the extent considered necessary.
- 2. Review all general journal entries.

Prepared by: _____

Date: _____

Reviewed by: _____

Date: _____

Client Acceptance Form--Part I

Client: _____

Date: _____

INSTRUCTIONS:

This form should be completed for all prospective clients for which compilation or review services are to be performed. The data on the form should be reviewed as a basis for initially accepting the client. The form should be updated and reviewed annually as a basis for maintaining an understanding of the client and making decisions about retaining the client.

PART I--BACKGROUND INFORMATION

CLIENT'S LEGAL NAME: _____

ADDRESS: _____

PHONE: _____

FEDERAL I.D. NO.: _____

STATE I.D. NO.: _____

1. Describe the nature of the client's business:

2. Identify the type of entity (e.g., proprietorship, partnership, regular corporation, S Corporation, or nonprofit): _____

3. List key owners, officers, and directors of the client:

Name	% Owned	Position

4. Identify any related businesses or individuals:

Name	Nature of Relationship

5. Identify the client's predecessor accountants:

Name:
Address:
Contact person:

6. Did we decide to contact the predecessor accountants? _____

If so, list their comments:

7. Describe the client's relationships with financial institutions:

Name	Type of A/Cs or Loans	Account Executive

8. Describe the services to be provided:

Service	How Often?			Report Deadlines
	Monthly	Quarterly	Annually	

Other Services:

Federal Tax Returns _____

State Tax Returns _____

Payroll Tax Returns _____

_____ Tax returns for principal owners _____

Which ones? _____

9. Will the financial statements and reports be used for high-risk purposes, e.g., to obtain significant amounts of new credit, to obtain performance bonding, or for purchase of the business? _____

Describe use of the financial statements:

10. Does the client have potential going-concern problems? _____

If so, describe them:

11. Describe the client's major sources of financing:

12. Describe any significant engagement performance, accounting or tax problems with which we should be concerned:

13. Describe the billing arrangements:

14. Describe any potential independence problems with respect to the client:

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or
Updated by:

Reviewed by:
(Partner)

Client Acceptance Form--Part II

Client: _____

Date: _____

	<u>Yes</u>	<u>No</u>
1. Is there any reason to doubt the integrity of management (owners)?	<input type="checkbox"/>	<input type="checkbox"/>
2. Are we aware of any significant disagreements between management (owners) and the predecessor accountant?	<input type="checkbox"/>	<input type="checkbox"/>
3. Does there appear to be any potential fee collection problems?	<input type="checkbox"/>	<input type="checkbox"/>
4. Are the client's needs beyond our capabilities or staffing abilities?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are we aware of any independence problems that may affect our ability to meet the client's needs?	<input type="checkbox"/>	<input type="checkbox"/>
6. Are there high-risk factors related to the engagement that may affect our decision to accept the client?	<input type="checkbox"/>	<input type="checkbox"/>
7. Is there a potential problem with management (owners) not fully understanding the limitations of the services to be provided (e.g., for the detection of fraud)?	<input type="checkbox"/>	<input type="checkbox"/>

For any "Yes" answers, explain how we plan to mitigate the problem (for example, by assigning more experienced personnel to the engagement, obtaining outside consultants, obtaining a retainer from the client, etc.):

Acceptance Decision:

Yes ____ No ____

Engagement Partner: _____ Date: _____

Concurring Partner: _____ Date: _____

Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements

Client:

Date:

INSTRUCTIONS:

This form should be completed for all compilation and review engagements (other than for personal financial statements). When used in conjunction with the *Client Acceptance Form*, the form provides documentation of the required understanding of the client's business and industry. It should be reviewed and updated annually for any changes in the client's business.

I. INDUSTRY INFORMATION

A. Describe major types of products or services provided by the client:

	% of Volume

B. Describe any sources of information about the client's accounting principles (e.g., AICPA guides, industry publications):

II. ACCOUNTING PRINCIPLES

A. What is the basis of accounting to be used for the financial statements both on an annual and interim basis [GAAP or Other Comprehensive Basis of Accounting (OCBOA)]?

1. Annual financial statements:

2. Interim financial statements:

B. Describe the client's significant accounting policies:

III. ACCOUNTING RECORDS

A. What is the form of the client's accounting records?

<u>Record</u>	<u>Form of the Records</u> <u>Manual/Computer</u>		<u>Personnel Responsible</u>
Journals:			
Cash receipts	M	C	_____
Cash disbursements	M	C	_____
Sales	M	C	_____
Purchases/Voucher	M	C	_____
Payroll	M	C	_____
General	M	C	_____
_____	M	C	_____
_____	M	C	_____
Ledgers:			
General	M	C	_____
Accounts Receivable	M	C	_____
Accounts payable	M	C	_____
Perpetual Inventory	M	C	_____
Physical Inventory Schedule	M	C	_____
_____	M	C	_____
_____	M	C	_____

B. If the client uses accrual basis accounting, describe the client's procedures, if any, for achieving an adequate cut-off of transactions when the financial statements are prepared.

C. If applicable, describe the client's procedures for taking a physical count of its inventory. State how often it is taken.

IV. STATED QUALIFICATIONS OF ACCOUNTING PERSONNEL

<u>Name</u>	<u>Responsibilities</u>	<u>Qualifications</u>

V. OTHER INFORMATION

A. Is there economic dependency on a major customer? _____ If so, describe customer and percent of sales.

B. Describe the nature of any stock plans (e.g., stock options, repurchase, etc.).

C. Describe any transactions with related parties, including the nature of the relationship.

D. Describe any other information that is significant to the engagement.

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or
Updated by:

Reviewed by:
(Partner)

Compilation Engagement Work Program

Client: _____

Financial Statement Date: _____

INSTRUCTIONS:

The following is a general guide for compiling annual and interim financial statements. Any additional inquiries or procedures performed, and conclusions reached, should also be documented in the working papers. The "N/A" column should be checked for any steps that are not applicable or for steps not required because of immateriality or other reasons. References preceded by "AR" are to *Statements on Standards for Accounting and Review Services*, included in volume 2 of the *AICPA Professional Standards*.

	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Prepare or update the Client Acceptance Form.	_____	_____	<input type="checkbox"/>
2. Consider whether the CPA firm is independent of the client. If the firm is not independent, the compilation report should be modified to indicate that fact. (AR 100.22)	_____	_____	<input type="checkbox"/>
3. Establish or update an understanding with the client, preferably in writing, regarding the nature of the engagement. Include in the working papers a copy of the engagement letter or a memorandum describing the oral arrangements. (AR 100.08)	_____	_____	<input type="checkbox"/>
4. If the firm was originally engaged to perform a higher level of service, i.e., a review or audit, document the appropriateness of the decision to step-down, including a consideration of:			
a. The reason given for the client's request, particularly the implications of a restriction on the scope of the initial engagement, whether imposed by the client or by circumstances.	_____	_____	<input type="checkbox"/>
b. The additional effort required to complete the initial engagement.	_____	_____	<input type="checkbox"/>
c. The estimated additional cost to complete the initial engagement. (AR 100.44-.49)	_____	_____	<input type="checkbox"/>

	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
5. Consider whether the staffing and scheduling of the engagement is appropriate.	_____	_____	<input type="checkbox"/>
6. Complete or update the Form to Document Understanding of Client's Business and Industry-Compilation and Review Engagements.	_____	_____	<input type="checkbox"/>
7. Obtain assurances about the independence of any other accountants engaged to perform segments of the engagement.	_____	_____	<input type="checkbox"/>
8. Perform any accounting services required to compile the financial statements. (AR 100.11)	_____	_____	<input type="checkbox"/>
9. Consider whether any information supplied by the client appears to be incorrect, incomplete, or otherwise unsatisfactory. If so, request revised information. (AR 100.12)	_____	_____	<input type="checkbox"/>
10. Draft the financial statements and the compilation report.	_____	_____	<input type="checkbox"/>
11. If the financial statements do not omit substantially all disclosures, complete the Financial Statement Disclosure Checklist.	_____	_____	<input type="checkbox"/>
12. If the financial statements are prepared on some other comprehensive basis of accounting, consider whether the financial statement titles and disclosure of the basis of accounting are appropriate. (AR 100.19-.21)	_____	_____	<input type="checkbox"/>
13. Read the financial statements and consider whether they appear to be appropriate in form and free from obvious material misstatements. (AR 100.13)	_____	_____	<input type="checkbox"/>
14. If the financial statements omit substantially all disclosures required by generally accepted accounting principles (GAAP) or some other comprehensive basis of accounting (OCBOA), add an additional paragraph to the compilation report disclosing the omission. (AR 100.19-.21)	_____	_____	<input type="checkbox"/>

	PERFORMED BY		N/A
	<u>Initials</u>	<u>Date</u>	
15. If GAAP basis financial statements of a business entity that omit substantially all disclosures also omit the statement of cash flows, modify the additional paragraph to disclose the omission. (AR 100.21 and footnote 8)	_____	_____	<input type="checkbox"/>
16. If the financial statements contain a departure from GAAP or OCBOA, including either a measurement or disclosure departure:			
a. Revise the financial statements or modify the compilation report to indicate the departure.	_____	_____	<input type="checkbox"/>
b. If the financial statements are not revised, consider whether modification of the standard report is adequate to indicate the deficiencies in the financial statements.	_____	_____	<input type="checkbox"/>
c. If modification of the report is not considered adequate, consider withdrawing from the engagement. (AR 100.39-.41)	_____	_____	<input type="checkbox"/>
17. If the financial statements are presented with comparative financial statements for one or more prior periods, determine that all financial statements are appropriately reported on by the CPA firm or a predecessor CPA firm. (AR 200.01-.36)	_____	_____	<input type="checkbox"/>
18. If financial statements that are presented in a prescribed form are being reported on in accordance with SSARS No. 3, determine that the report complies with the requirements of that Statement. (AR 300.01-.05)	_____	_____	<input type="checkbox"/>
19. If supplementary data accompanies the financial statements, modify the compilation report to include the other data. (AR 100.43)	_____	_____	<input type="checkbox"/>
20. Include a reference to the compilation report on each page of the financial statements and supplementary data. (AR 100.16)	_____	_____	<input type="checkbox"/>
21. Date the compilation report as of the date the compilation was completed. (AR 100.15)	_____	_____	<input type="checkbox"/>
22. Consider obtaining a representation letter.	_____	_____	<input type="checkbox"/>

	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
23. Document any other procedures performed or unusual problems and their resolution.	_____	_____	<input type="checkbox"/>
24. Determine that all required forms and checklists have been completed.	_____	_____	<input type="checkbox"/>
25. Determine that all review points by the engagement team and the technical reviewer (if, applicable) have been resolved.	_____	_____	<input type="checkbox"/>

Prepared by: _____
(In-Charge)

Date: _____

Reviewed by: _____
(Partner)

Date: _____

Technical Review Checklist--Compilation and Review Engagements

Client: _____

Financial Statement Date: _____

Technical Reviewer: _____

Date: _____

INSTRUCTIONS:

This form should be completed by the technical reviewer on those engagements specified by the CPA firm's quality control policies and procedures.

Initials

1. Review the financial statements for appropriate form and content. Consider the appropriateness of:
 - a. Titles. _____
 - b. Captions. _____
 - c. Classifications within captions. _____
 - d. Descriptions. _____
 - e. Reference to Accountant's Report and financial statement notes. _____
2. Compare the Financial Statement Disclosure Checklist to the notes to the financial statements. Consider whether the notes are complete and worded appropriately. _____
3. Review the financial statements for any obvious departures from GAAP or OCBOA. _____
4. Review the engagement checklists:
 - a. To determine that they have been completed. _____
 - b. For potential problems. _____
5. Describe any problems noted and the way they were resolved. _____

Signer's Checklist--Compilation and Review Engagements

Client: _____

Financial Statement Date: _____

Partner: _____

Date: _____

INSTRUCTIONS:

This form should be completed by the engagement partner for all compilation and review engagements. The form is designed to document performance of the engagement in accordance with the firm's quality control policies and procedures, and to authorize the release of the financial statements and the report.

Initials

1. I have reviewed the Compilation (Review) Work Program.

2. I have reviewed the Technical Review Checklist, if applicable.

3. I have reviewed the financial statements for appropriate form and departures from GAAP or OCBOA.

4. I have reviewed the accountant's report.

5. I authorize issuance of the financial statements and the report.

Financial Statement Control Form

Client: _____

Financial Statement Date: _____

SERVICE PERFORMED:

COMPILATION

REVIEW

	PERFORMED BY		N/A
	Initials	Date	
1. Submit financial statements and report to typing.	_____	_____	<input type="checkbox"/>
2. Proofread the financial statements and report.	_____	_____	<input type="checkbox"/>
3. Resubmit the financial statements and report for correction.	_____	_____	<input type="checkbox"/>
4. Submit to technical reviewer, if applicable.	_____	_____	<input type="checkbox"/>
5. Resubmit the financial statements and report for corrections.	_____	_____	<input type="checkbox"/>
6. Submit to engagement partner for final review.	_____	_____	<input type="checkbox"/>
7. Release the financial statements and report.	_____	_____	<input type="checkbox"/>

Number of Copies:

Bound: _____ Unbound: _____

Other: _____

CHAPTER 5
REPORTING ON FINANCIAL STATEMENT COMPILATION ENGAGEMENTS

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CHAPTER 5

REPORTING ON FINANCIAL STATEMENT COMPILATION ENGAGEMENTS

5.000 THE STANDARD COMPILATION REPORT

5.001 Paragraph 14 of SSARS No. 1 states that financial statements compiled by an accountant should be accompanied by a report that states:

- A compilation has been performed in accordance with standards established 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.
- The financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them.

5.002 The report should not describe any other procedures performed as a part of the compilation engagement, because users of the report may place undue reliance on the procedures. The report ordinarily should be addressed to the board of directors, stockholders, partners, general partner, or proprietor of the client.

5.003 Each page of the financial statements (including the notes to the financial statements) and accompanying supplementary information should include a reference to the accountant's report, such as "See Accountant's Compilation Report." The date of completion of the compilation should be used as the date of the accountant's report.

5.004 An exposure draft of SSARS No. 7 includes a proposed change in the wording of the standard compilation report to indicate that the compilation was performed "in accordance with Statement on Standards for Accounting and Review

Services issued by the American Institute of Certified Public Accountants." This proposal is designed to clearly identify the standards that apply to a compilation engagement for a nonpublic company. (See Chapter 1 for a summary of the exposure draft.)

Reporting on the Highest Level of Service

5.005 As indicated in Chapter 4, the accountant may need to perform other accounting services to facilitate compilation of the client's financial statements. Paragraph 5 of SSARS No. 1 states that when an accountant performs more than one service with respect to the financial statements of an entity, he or she should issue the report that is appropriate for the highest level of service rendered. This *highest level of service* provision is frequently misunderstood. Many accountants believe it requires them to evaluate the work performed on the financial statements and then issue the report appropriate for that level of service. For example, these accountants believe that if they are engaged to compile a client's financial statements, yet they perform review procedures (i.e., inquiries and analytical procedures), they are required to issue a review report. This is not the case. When the accountant is engaged to perform a compilation engagement and performs review procedures in conjunction with that engagement, there is no requirement to upgrade and issue a review report. The intent of this provision in SSARS No. 1 is to make it clear that when the accountant is engaged to review the financial statements but has to compile them first, he or she is not required to issue both a compilation and review report. Issuing two different reports on the same financial statements could confuse the users of the financial statements as to responsibility being assumed by the accountant. When the accountant is in a position to issue a review report for a compilation engagement, he or she may wish to discuss the matter with the client and they may revise the understanding about the services to be provided. (See SSARS No. 1, Interpretation No. 3, *Reporting on the Highest Level of Service*.)

Reporting on the Compilation of Only One Financial Statement

5.006 An accountant may be engaged to compile and report on only one basic financial statement, for example, only the balance sheet. SSARS No. 1 allows the accountant to perform such services, provided the engagement does not result from a restriction on the scope of the accountant's work.

5.007 The accountant's compilation report on only one financial statement should refer only to that statement. Also, unless the accountant's report is modified to indicate that management has elected to omit substantially all required disclosures, the financial statement should be accompanied by all of the notes relevant to that statement. (See pages 5-24 and 5-25 of the Sample Compilation Reports section of this chapter for illustrative reports.)

5.100 MODIFICATIONS TO THE STANDARD COMPILATION REPORT

Reporting When the Statement of Cash Flows Is Omitted

5.101 Generally accepted accounting principles (FASB Statement No. 95, *Statement of Cash Flows*) requires presentation of a statement of cash flows for each period that a balance sheet and an income statement are presented. Therefore, omission of the statement of cash flows in the financial statements of a profit-oriented business constitutes a departure from GAAP that must be indicated in the accountant's report. However, there are exceptions. Unless specifically requested, a statement of cash flows is not required when financial statements are presented in prescribed forms, or as special purpose financial presentations in compliance with contractual agreements or regulatory requirements. In addition, a statement of cash flows is not required for OCBOA or personal financial statements, and when only one financial statement (e.g., a balance sheet or an income statement) is presented. (See page 5-21 of the Sample Compilation Reports section of this chapter for an illustrative report.)

Reporting When the Accountant Is Not Independent

5.102 As discussed in Chapter 3, an accountant may compile financial statements of a client, even though the accountant is not independent, provided he or she complies with the requirements of SSARS. However, the accountant must modify the compilation report by adding the following additional paragraph:

I am (We) are not independent with respect to XYZ Company.

(See page 5-18 of the Sample Compilation Reports section of this chapter for a complete illustrative report.)

5.103 An accountant determines whether the CPA firm is independent with respect to a client by considering Rule 101 of the AICPA *Code of Professional Conduct*, and the related interpretations and rulings. The accountant should never describe in the compilation report the reasons for the lack of independence.

Practice Tip:

Accountants often overlook the effect of past due fees on the CPA firm's independence. If the CPA firm has not been paid for the prior year's compilation fee, the firm is not independent and the compilation report must be modified to indicate the lack of independence. (See paragraphs 3.004 through 3.007 of Chapter 3 for a more complete discussion of the conditions that impair accountant's independence.)

Reporting on Financial Statements That Omit Substantially All Disclosures

5.104 The accountant may compile financial statements that omit substantially all disclosures required by GAAP or OCBOA, provided that the omission, based on the accountant's knowledge, is not intended to mislead users of the statements. The accountant's report on financial statements that omit substantially all disclosures should be modified by adding the following third paragraph:

Management has elected to omit substantially all of the disclosures (and the statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

(See page 5-19 of the Sample Compilation Reports section of this chapter for a complete illustrative report.)

5.105 This additional paragraph handles omission of all required disclosures, including those in the notes to the financial statements and those normally presented on the face of the statements, such as the number of shares of common stock issued and outstanding. It is sufficient even when there is no disclosure of significant uncertainties or going-concern problems. However, the paragraph does not fulfill the accountant's responsibilities to point out departures from GAAP or OCBOA that are related to the measurement of items in the financial statements. The accountant is required to add an additional paragraph to describe any material measurement departures in the financial statements. (See paragraphs 5.108 through 5.113 of this chapter.)

5.106 If financial statements compiled in conformity with some other comprehensive basis of accounting do not include disclosure of the basis of accounting used, the basis should be disclosed in the accountant's report. (See Chapter 9 for a discussion of financial statements prepared on another comprehensive basis of accounting.)

5.107 A client may wish to include selected disclosures with financial statements that omit substantially all disclosures. To prevent users from assuming that the disclosures are complete, the accountant should include in his or her report the additional paragraph described above, and make sure that the disclosures are labeled as follows:

Selected Information--Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included

Reporting on Financial Statements With Departures From GAAP

5.108 An accountant who is engaged to compile financial statements may become aware of departures from GAAP or OCBOA that are material to the financial statements. In these circumstances, the following three options are available to the accountant:

- Convince the client to revise the financial statements.
- Modify the compilation report to disclose the departure.
- Withdraw from the engagement. (See paragraph 5.113.)

If the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departures. SSARS No. 1, Interpretation No. 6, *Withdrawal From Compilation or Review Engagements*, states that modification of the accountant's report is ordinarily adequate to indicate the deficiencies in the financial statements. However, in rare circumstances, the nature, extent and probable effect of the departures from GAAP or OCBOA might cause the accountant to question whether the departures were undertaken with the intention of misleading users of the financial statements. In those circumstances, withdrawal from the compilation engagement might be necessary; however, the accountant ordinarily would not decide to withdraw when the client agrees that the effects of the departures should be determined and disclosed in the accountant's report.

5.109 If the accountant decides that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph to the compilation report. The paragraph should include a description of the effects of the departure on the financial statements if management or the accountant has determined them. The accountant is not required to determine the effects of the departure if management has not done so, but the fact that the effects have not been determined should be disclosed in the accountant's report. (See pages 5-22 and 5-23 of the Sample Compilation Reports section of this chapter for illustrative reports.)

5.110 **Reporting When There Are Significant Departures From GAAP.** Occasionally, the accountant may compile financial statements that contain significant and pervasive departures from GAAP or OCBOA. In these circumstances, the accountant should not state in his or her report an overall conclusion that the financial statements are not presented in accordance with GAAP or OCBOA. To do so would be equivalent to expressing an adverse opinion on the financial statements taken as a whole. Such an opinion is only appropriate when the accountant has audited the financial statements.

5.111 When the financial statements contain departures that are significant and pervasive, the accountant may wish to emphasize the limitations of the financial statements in a separate paragraph, such as the one presented below:

Because the significance and pervasiveness of the matters discussed above makes it difficult to assess their impact on the financial statements taken as a whole, users of these financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in conformity with generally accepted accounting principles.

5.112 Inclusion of this emphasizing paragraph in the accountant's compilation report is not a substitute for disclosure of the specific departures and their effects on the financial statements when the effects have been determined.

5.113 If the accountant decides that modification of the standard report is not sufficient to disclose the deficiencies of the financial statements taken as a whole, the accountant should withdraw from the engagement and provide no further services with respect to that set of financial statements. The accountant may also want to consult with his or her attorney.

5.114 **What Is GAAP?** When evaluating whether a particular accounting principle used by a client is generally accepted, the accountant may refer to a variety of sources from Statements of the Financial Accounting Standards Board or the Governmental Accounting Standards Board to articles in accounting journals. While there is no official list of accounting principles, SAS No. 69, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*, provides guidance on the levels of authority of various sources of GAAP. The Statement divides the sources of GAAP into the following five categories:

1. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 of the AICPA *Code of Professional Conduct*. Rule 203 provides that a CPA should not (1) express an unqualified opinion on financial statements or (2) state that he or she is not aware of any material modifications that should be made to financial statements, if such statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronouncements would make the statements misleading. Rule 203 implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of

operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements.

2. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (1).
3. Pronouncements of bodies, organized by a body referred to in category (1) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (2) that have been cleared by a body referred to in category (1) but have not been exposed for public comment.
4. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.
5. Other accounting literature.

5.115 In contrast to prior guidance on sources of GAAP, this represents a true hierarchy from the highest level, (1), to the lowest level, (5). If the accounting treatment of a particular transaction or event is not specified by a pronouncement included in category (1), the accountant should consider whether the accounting treatment is specified by another source of accounting principles. In situations in which there is a conflict between the accounting treatment suggested by sources from different categories, the guidance in the higher category should be followed, or the accountant should be prepared to justify use of the guidance included in the lower category.

5.116 Most of the pronouncements or practices in categories (2), (3), and (4) had equal authoritative standing prior to the issuance of SAS No. 69. Therefore, SAS No. 69 contains a transition rule; clients following appropriate accounting principles before the effective date of the Statement need not change to an accounting principle of higher authority simply as a result of issuance of SAS No 69. Specifically, a client following an accounting treatment in category (3) or (4) as of March 15, 1992 (March 15, 1993 for Emerging Issues Task Force (EITF) Consensuses), need not change to an accounting treatment contained in a category (2) or a category (3) pronouncement whose effective date is before March 15, 1992 (March 15, 1993 for EITF

Consensuses). For accounting pronouncements with effective dates after March 15, 1992 (March 15, 1993 for EITF Consensuses), and for clients initially applying an accounting principle after March 15, 1992 (March 15, 1993 for EITF Consensuses), the accountant should follow the new hierarchy.

5.117 Table 5-1 summarizes the pronouncements that are included in each of the five categories of GAAP for nongovernmental entities and state and local governments.

Table 5-1

GAAP HIERARCHY SUMMARY

Nongovernmental Entities	State and Local Governments
Category 1	
FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Bulletins	GASB Statements and Interpretations, plus AICPA and FASB pronouncements if made applicable to state and local governments by a GASB Statement or Interpretation
Category 2	
FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position	GASB Technical Bulletins, and the following pronouncements if specifically made applicable to state and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position
Category 3	
Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins	Consensus positions of the GASB Emerging Issues Task Force and AICPA Practice Bulletins if specifically made applicable to state and local governments by the AICPA
Category 4	
AICPA accounting interpretations, "Os and As" published by the FASB staff, as well as industry practices widely recognized and prevalent	"Os and As" published by the GASB staff, as well as industry practices widely recognized and prevalent
Category 5	
Other accounting literature, including FASB Concepts Statements; AICPA Issues Papers; APB Statements; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles	Other accounting literature, including GASB Concepts Statements; pronouncements in categories (1) through (4) of the hierarchy for nongovernmental entities when not specifically made applicable to state and local governments; APB Statements; FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles

5.118 Departures From Promulgated Accounting Principles That Prevent the Financial Statements From Being Misleading. Rule 203 of the AICPA *Code of Professional Conduct* generally prohibits a CPA from issuing an unqualified audit opinion or an unmodified review report on financial statements that depart from promulgated GAAP (i.e., category (1) in Table 5-1). However, if the CPA can demonstrate that due to unusual circumstances the financial statements (that contain the departure) would be materially misstated if they applied the promulgated principle, the CPA can comply with Rule 203 by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in misleading financial statements. The CPA may then issue an unqualified audit opinion, or state in a review report that he or she is not aware of any material modifications that should be made to such statements in order for them to be in conformity with GAAP.

5.119 Rule 203 does not apply to compilation engagements because compilation reports provide no assurance that the financial statements are presented fairly in accordance with GAAP. As a result, the accountant should never indicate that application of the promulgated principle would result in misleading financial statements, because this may mislead users about the extent of assurance being provided by the compilation report. If the accountant encounters a Rule 203 situation in a compilation engagement, he or she should modify the report to describe the departure from GAAP as required by paragraphs 39 through 40 of SSARS No. 1.

5.120 What Is Material? Accountants should not issue an unmodified compilation report on financial statements that contain material deficiencies. The term *material* may be defined as "sufficiently important to influence decisions made by reasonable users of financial statements." Evaluating whether a departure from GAAP or OCBOA is material involves professional judgment.

5.121 Materiality depends on both the dollar amount and the nature of the item. For example, an amount that is material to the income statement might not be material if it only affects the client's balance sheet. In addition, a lower level of materiality is typically applied to the disclosure of related party transactions than is applied to other items in the financial statements.

5.122 Accountants agree that materiality is relative rather than absolute. As clients increase in size, amounts that are material to their financial statements also increase. Therefore, materiality guidelines generally are specified as a percentage of some base, such as net income before taxes, total revenues, or total assets. A common rule of thumb for materiality is 5 to 10 percent of income before taxes. Some accountants apply this rule such that 5 percent of normal net income before taxes is considered immaterial, above 10 percent is considered material. For departures between 5 and 10 percent, judgment is applied.

5.123 Some accountants use a sliding scale percentage of total assets or total

revenues to determine materiality. The following is an example of materiality guidelines that use this method:

<u>Materiality Base</u> <u>(Total Assets or Revenues)</u>	<u>Percentage</u>
Up to \$50,000	5.0%
Above \$50,000 to \$100,000	4.0%
Above \$100,000 to \$300,000	3.5%
Above \$300,000 to \$1,000,000	2.5%
Above \$1,000,000 to \$3,000,000	1.5%
Above \$3,000,000 to \$10,000,000	1.0%

Reporting on Uncertainties

5.124 Financial Statements presented in accordance with GAAP or OCBOA should disclose information about significant uncertainties affecting the client's financial statements, including those related to the client's ability to continue as a going concern. As long as the accountant believes that disclosures about uncertainties are adequate, there is no need to modify the compilation report. The accountant, however, may decide to add a paragraph to his or her report to emphasize those uncertainties. (See page 5-27 in the Sample Compilation Reports section of this chapter for an illustrative report.)

5.125 Uncertainties are matters that (1) may affect the client's financial statements, (2) will be resolved by the occurrence of some future event, and (3) are not susceptible of reasonable estimation by management. Examples of uncertainties include litigation against the client, governmental and regulatory actions, contracts under renegotiation or dispute, and tax disputes when precedents are not clear.

5.126 Uncertainties should not be confused with accounting estimates. Matters whose outcomes depend on the actions of management and relate to typical business operations generally are susceptible to reasonable estimation. Therefore, they are estimates inherent in the accounting process and not uncertainties. Examples of these matters include estimates of uncollectible receivables, warranty obligations, income taxes, and inventory losses due to obsolescence. Estimation of these matters is required for the financial statements to be in accordance with GAAP. The accountant should treat the matter as a GAAP departure if an estimate is not made, or the accountant believes that management's estimate is unreasonable.

5.127 FASB Statement No. 5, *Accounting for Contingencies*, describes the

accounting for the most common type of uncertainties, loss contingencies. This Statement divides loss contingencies into three categories based on the probability of unfavorable outcome, and provides the following guidance about accounting for them:

- Contingent losses should be accrued and recorded in the financial statements if (1) information available prior to the issuance of the financial statements indicates that it is probable that a loss has been sustained at the balance sheet date, and (2) the amount of the loss can be reasonably estimated.
- Contingent losses that do not meet the above criteria should be disclosed in the notes to the financial statements when occurrence of the loss is at least reasonably possible.
- Contingent losses need not be disclosed when occurrence of the loss is remote, with the exception of those that are traditionally disclosed, such as guarantees of indebtedness of others, and guarantees to repurchase receivables that have been sold.

5.128 Disclosure in the notes to the financial statements of a loss contingency should include the nature of the contingency and give an estimate of the possible loss (or range of loss) or state that such an estimate cannot be made. When considering the adequacy of disclosures about loss contingencies in compiled financial statements, the accountant should look to the guidance in FASB Statement No. 5.

5.129 **Uncertainty About Ability to Continue As a Going Concern.** A special type of significant uncertainty is the ability of a client to continue as a going concern. Conditions that might cause the accountant to question whether there is a significant uncertainty about the client's ability to continue as a going concern include matters such as negative cash flows from operations, defaults on loan agreements, adverse financial ratios, work stoppages, and legal or regulatory proceedings.

5.130 The accountant's obligation is the same for a going-concern uncertainty as for other uncertainties--the adequacy of financial statement disclosures must be considered. Provided the financial statements appropriately disclose the uncertainty, the accountant is not required to modify his or her report. The accountant may, however, elect to add a separate emphasis-of-a-matter paragraph to his or her report that discusses a going concern uncertainty. (See page 5-28 in the Sample Compilation Reports section of this chapter for an illustrative report.)

5.131 Although FASB Statement No. 5 contains guidance about disclosures of uncertainties in general, it does not address specific disclosure requirements for going concern uncertainties. Such guidance has been developed by the AICPA's auditing standards board for auditors and is included in SAS No. 59, *The Auditor's*

Consideration of an Entity's Ability to Continue as a Going Concern. SSARS No. 1, Interpretation No. 11, *Reporting on Uncertainties*, requires accountants to consider the disclosure guidance for going concern uncertainties in paragraphs 10 and 11 of SAS No. 59 when performing compilation and review engagements. SAS 59 indicates that the following types of information about the uncertainty might be disclosed:

- Pertinent conditions and events giving rise to substantial doubt about the entity's ability to continue as a going concern
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations
- Management's plans, including consideration of any relevant prospective information
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

5.132 Accountant's Responsibility to Identify Going Concern Problems. The preceding discussion assumes the accountant is already aware of a going concern problem. Many accountants have questioned whether they are required, in a compilation engagement, to look for conditions that indicate such a problem. The authors believe that, although there is no such requirement, accountants should be alert for conditions that raise doubts about the client's ability to continue to operate. As mentioned in Paragraph 5.131, if such a conditions are identified, the accountant should refer to SAS No. 59 for guidance on evaluating the potential going concern problem and the disclosure required, if any. In other words, even though there is no requirement to look for a going concern problem, if the accountant discovers a problem during the course of the engagement, he or she should consider its effects on the financial statements.

Reporting on Inconsistencies

5.133 Reporting on inconsistencies in the application of acceptable accounting principles in a compilation engagement is similar to reporting on uncertainties. When the financial statements adequately disclose such inconsistencies, the accountant is not required to modify his or her compilation report. APB Opinion No. 20, *Accounting Changes*, provides guidance about the accounting treatment and disclosure of changes in accounting principles. (See paragraphs 13.102 through 13.108 of

Chapter 13 for a discussion of these accounting requirements.)

Scope Limitations

5.134 SSARS includes no provisions for reporting on engagements in which the scope of the accountant's work has been restricted. In compiling financial statements, the accountant may become aware that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory. In such circumstances, SSARS No. 1 states that the accountant should obtain additional or revised information. If the client refuses to provide the information, the accountant should withdraw from the engagement.

Reporting When Supplementary Information Accompanies Compiled Financial Statements

5.135 The accountant's compilation report covers the basic financial statements: balance sheet, income statement, statement of retained earnings or changes in stockholders' equity, and statement of cash flows. It also covers descriptions of accounting policies, notes to financial statements, and schedules and explanatory material identified as being part of the basic financial statements. However, the basic financial statements may be accompanied by other information for supplementary analysis purposes, such as:

- Details or explanations of items in or related to the financial statements
- Consolidating information
- Historical summaries of items extracted from the financial statements
- Other financial and nonfinancial data

5.136 When supplementary information accompanies compiled financial statements, the accountant should provide an indication of the extent of responsibility, if any, taken with respect to the information. When the accountant has compiled both the financial statements and the supplementary information, the accountant's report on the financial statements may be expanded to include the information, or the accountant may include a separate compilation report on the supplementary information. (See page 5-26 in the Sample Compilation Reports section of this chapter for an illustrative report.)

Subsequent Discovery of Facts About a Compiled Financial Statement

5.137 Subsequent to the date of the compilation report, the accountant may become aware of facts that may have existed at the report date which might have caused the accountant to believe that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory. Paragraph 42 or SSARS No. 1 indicates that in those circumstances, the accountant may wish to consider the guidance in SAS No. 1, section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, in determining the appropriate course of action.

5.200 SAMPLE COMPILATION REPORTS

5.201 The following pages are illustrative reports for various compilation engagement reporting situations.

5.202 As discussed in Chapter 1, an exposure draft of SSARS No. 7 has been issued that proposes a change to the standard compilation report. The illustrative compilation reports in this chapter do not reflect the proposed change, because, if adopted, the proposed SSARS will not be effective before 1993. However, users of this manual should be alert for issuance of the final SSARS.

Sample Compilation Reports

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Standard Compilation Report

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

(Firm's signature)

_____ [Report Date]

Note:

This reporting guidance assumes that a combined statement of income and retained earnings is presented. If a separate statement of retained earnings is presented, the report should be worded as follows:

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings, and cash flows for the _____ [Period] then ended,...

Compilation Report--Lack of Independence

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

I am (We are) not independent with respect to _____ [Client Name].

(Firm's signature)

_____ [Report Date]

Compilation Report--Substantially All Disclosures Omitted

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

(Firm's signature)

_____ [Report Date]

Compilation Report--Substantially All Disclosures and Statement of Cash Flows Omitted

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statement of income and retained earnings for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures and the statement of cash flows required by generally accepted accounting principles. If the omitted disclosures and statement of cash flows were included, they might influence the user's conclusions about the Company's financial position, results of operations, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

(Firm's signature)

_____ [Report Date]

Compilation Report--Statement of Cash Flows Omitted

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statement of income and retained earnings for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

A statement of cash flows for the _____ [Period] ended _____ [Financial Statement Date] has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

(Firm's signature)

_____ [Report Date]

Compilation Report--Departure From GAAP With Effect Determined

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

As disclosed in Note D to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the Company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

(Firm's signature)

_____ [Report Date]

Compilation Report--Departure From GAAP With Effect Not Determined

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

As disclosed in Note D to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory cost of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and the effect of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows has not been determined.

(Firm's signature)

_____ [Report Date]

Compilation Report--Balance Sheet Only

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] in accordance with standards established 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 (the owners). I (We) have not audited or reviewed the accompanying balance sheet and, accordingly, do not express an opinion or any other form of assurance on it.

(Firm's signature)

_____ [Report Date]

Compilation Report--Balance Sheet Only, With Substantially All Disclosures Omitted

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] in accordance with standards established 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 balance sheet and, accordingly, do not express an opinion or any other form of assurance on it.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statement, they might influence the user's conclusions about the Company's financial position. Accordingly, this financial statement is not designed for those who are not informed about such matters.

(Firm's signature)

_____ [Report Date]

Compilation Report--Financial Statements Accompanied by Supplementary Information

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, and the accompanying _____ [Identify the Supplementary Information], in accordance with standards established by the American Institute of Certified Public Accountants.

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

(Firm's signature)

_____ [Report Date]

Compilation Report--Emphasis of an Uncertainty

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

As discussed in Note __, the Company is currently a defendant in a lawsuit alleging sale of a defective product and claiming compensating and punitive damages. The Company has filed a counteraction, and preliminary hearings and discovery proceedings on both actions are in process. The ultimate outcome of the lawsuit cannot be presently determined. Accordingly, no provision for any liability that may result upon adjudication has been made in the accompanying financial statements.

(Firm's signature)

_____ [Report Date]

Compilation Report--Emphasis of a Going Concern Uncertainty

I (We) have compiled the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established 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 and, accordingly, do not express an opinion or any other form of assurance on them.

As discussed in Note __, certain conditions indicate that the Company may not be able to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

(Firm's signature)

_____ [Report Date]

CHAPTER 6
PERFORMING FINANCIAL STATEMENT REVIEW ENGAGEMENTS

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CHAPTER 6

PERFORMING FINANCIAL STATEMENT REVIEW ENGAGEMENTS

6.000 WHAT IS A REVIEW?

6.001 As discussed in paragraph 2.201 of Chapter 2 SSARS No. 1 created a service that permits an accountant to express limited assurance on the financial statements of a nonpublic entity. That service is a review. Paragraph 4 of SSARS No. 1 defines a review as--

Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable, with an other comprehensive basis of accounting.

6.002 A review differs from a compilation in two principal ways. First, the accountant expresses limited assurance in a review, whereas no assurance is expressed in a compilation. Second, the accountant is required to perform specific types of procedures in a review--inquiries and analytical procedures--to obtain a reasonable basis for expressing that assurance. In a compilation, no specific procedures, other than reading the financial statements, are required.

What Are the Requirements of a Review?

6.003 An accountant who reviews financial statements must meet five specific performance requirements as well as certain reporting requirements. In general, these requirements are:

- Establish an understanding with the entity regarding the services to be performed and the report the accountant expects to render.
- Have or obtain knowledge of the accounting principles and practices of the entity's industry and an understanding of the entity's business that will provide him or her, through the performance of inquiry and

analytical procedures, with a reasonable basis for expressing limited assurance.

- Perform inquiry and analytical procedures sufficient to provide a reasonable basis for expressing limited assurance.
- Perform additional procedures when the accountant becomes aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. These procedures should be sufficient to achieve limited assurance.
- Obtain a representation letter from the owner, manager, or chief executive officer, and, if appropriate, the chief financial officer. The exposure draft of SSARS No. 7 proposes this requirement. (See Chapter 1 for a summary of that exposure draft.)
- Consider whether to modify his or her report if in the review of the financial statements the accountant becomes aware of a departure from GAAP (or OCBOA) that is material to the financial statements and the financial statements are not revised. (Reporting for review engagements is discussed in detail in Chapter 7.)

A flowchart for performing review services is presented in Table 6-1.

6.100 ESTABLISHING AN UNDERSTANDING WITH THE CLIENT

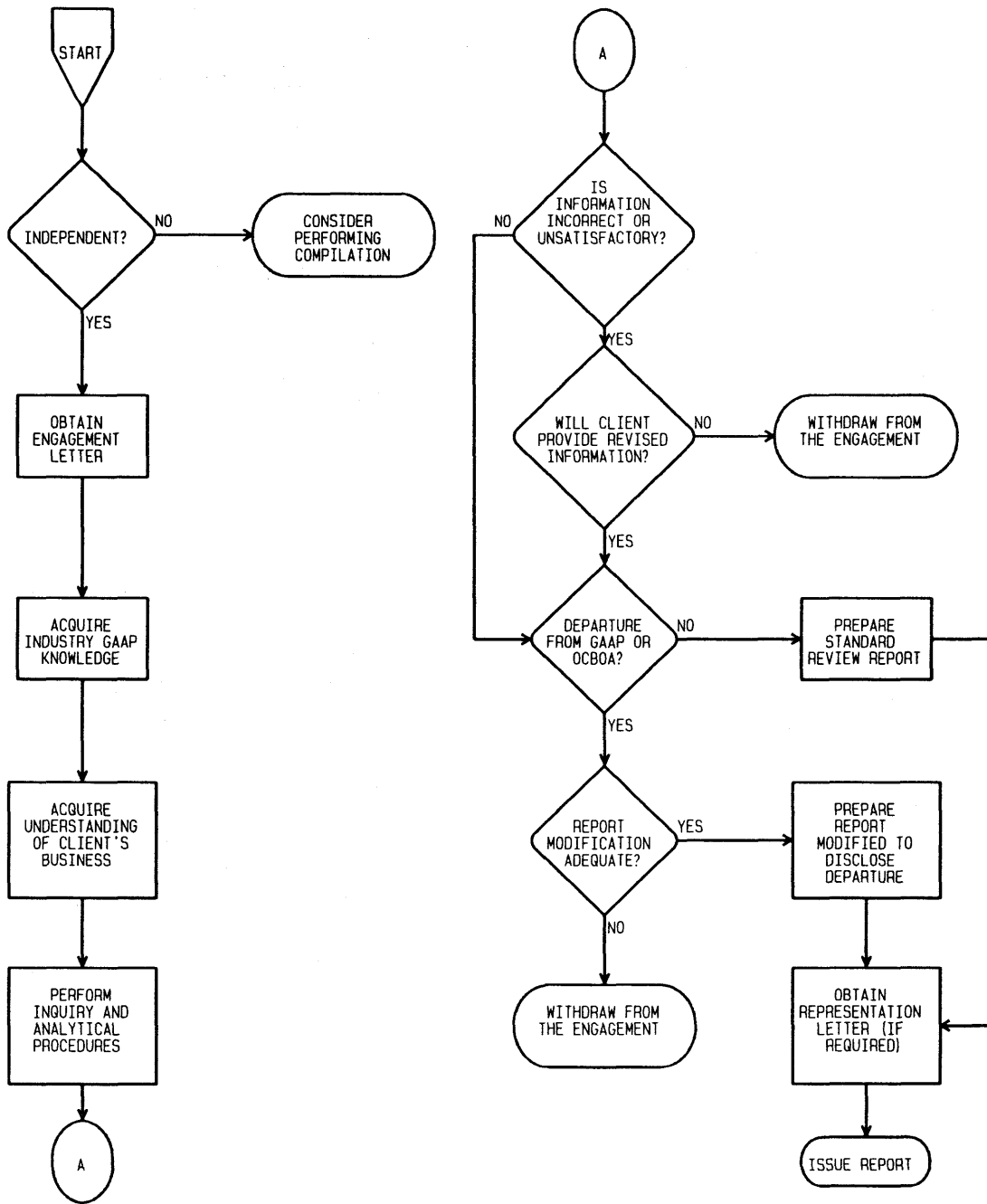
6.101 Once the accountant has decided to accept a review engagement, he or she should establish an understanding with the client, preferably in writing, regarding the services to be performed, the terms and objectives of the engagement, and the type of report anticipated. (Section 3.100 of Chapter 3 provides guidance on engagement letters for review engagements.)

6.200 KNOWLEDGE OF THE INDUSTRY AND BUSINESS

6.201 To perform a review the accountant is required to have a knowledge of the accounting principles and practices of the industry in which the client operates and an understanding of the client's business. Similar requirements exist when the accountant performs a compilation service. However, greater knowledge of these two areas is necessary for a review than for a compilation.

Table 6-1

FLOWCHART FOR PERFORMING REVIEW SERVICES



6.202 The reason for the difference in knowledge requirements stems from the difference in the objectives of the two engagements. In a compilation, the accountant must have sufficient knowledge to put financial information in the form of financial statements, but in a review the accountant's knowledge must be sufficient to express, in conjunction with inquiry and analytical procedures, limited assurance on the financial statements.

Knowledge of Client's Industry

6.203 To review financial statements, the accountant should know enough about the accounting principles and practices in the client's industry both to understand the proper form and content of its financial statements and to design, perform, and evaluate the results of the inquiry and analytical procedures necessary to achieve limited assurance.

6.204 In the authors' opinion, this does not mean that the accountant must be a specialist in the client's industry. It simply requires that the accountant be familiar with the accounting principles and practices particular to that industry. Such a familiarity is necessary to properly apply the inquiry and analytical procedures required in a review.

6.205 SSARS No. 1 does not require the accountant to possess industry knowledge prior to accepting a review engagement. As long as the accountant obtains the required knowledge before the review is completed, the SSARS requirement is satisfied. A number of sources usually are available to the accountant to assist in obtaining industry knowledge. AICPA accounting and audit guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, and consultation with individuals knowledgeable about the industry are examples of common sources.

Knowledge of Client's Business

6.206 Paragraph 26 of SSARS No. 1 requires the accountant to have a general understanding of the client's business in the following specific areas:

- The entity's organization
- The entity's operating characteristics
- The nature of the entity's assets, liabilities, revenues and expenses

The paragraph goes on to state that knowledge of the business also normally includes a general understanding of the entity's production, distribution, and compensation methods; types of products and services; operating locations; and material

transactions with related parties.

6.207 To determine how much knowledge of the entity's business is necessary to perform a review, emphasis should be placed on the term *general understanding* used in SSARS. The term general understanding means an overall familiarity or awareness, not an in-depth knowledge. Completing the Client Acceptance Form, the Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements, and the Form For Documenting Understanding of Client's Business and Industry--Supplement for Review Engagement included in the Documentation Assistance section of this chapter will ordinarily provide an understanding of the client's business that meets the requirements of SSARS.

6.208 The accountant usually obtains an initial understanding of the client's business by making inquiries and observations and looking at relevant documents. After obtaining the initial understanding, the accountant need only update it in succeeding engagements.

6.300 CLIENT REPRESENTATION LETTERS

6.301 The exposure draft of SSARS No. 7 (as summarized in Chapter 1) proposes a requirement that the accountant obtain a written representation letter from the client for all review engagements. Such letters, however, are not required as of the date this manual was written. Users of this manual should monitor the current status of the exposure draft to determine if requirements have changed. In any event, the authors recommend that representation letters be obtained in all review engagements because these engagements provide assurance about the financial statements and such letters provide useful evidence for developing that assurance. An example representation letter for a review engagement is presented on page 6-45 of the Documentation Assistance section of this chapter.

6.400 INQUIRIES

6.401 Inquiries involve asking questions of entity personnel about significant financial statement matters. For inquiries to be effective, they should be directed to entity personnel who are likely to be knowledgeable about the subject of the inquiry--that is, persons having responsibility for financial and accounting matters.

6.402 Although inquiries must be made in a review, the accountant has considerable flexibility in determining their nature and extent. Factors the accountant

should consider when deciding which inquiries to make include (1) knowledge acquired in current and previous engagements, (2) the nature and materiality of financial statement items, (3) the likelihood of misstatement in a financial statement item, (4) the stated qualifications of accounting personnel, (5) the extent to which a particular item is affected by management's judgment, and (6) inadequacies in the entity's underlying financial data.

6.403 Paragraph 27 of SSARS No. 1 identifies the following major areas for the accountant's inquiries:

- The entity's accounting principles and practices and the methods of applying them.
- The entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements.
- Actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.
- Whether the financial statements have been prepared in conformity with GAAP consistently applied.
- Whether there have been changes in the entity's business activities or accounting principles and practices.
- Matters about which questions have arisen in the course of applying review procedures, including analytical procedures.
- Events subsequent to the date of the financial statements that would have a material effect on the financial statements.

6.404 The Review Engagement Work Program on page 6-31 of the Documentation Assistance section of this chapter presents typical inquiries that may be made in a review. These inquiries pertain to common financial statement accounts and areas described in SSARS No. 1. However, as stated in the instructions to the work program, the accountant might decide to omit some inquiries or add others based on the factors noted in paragraph 6.402 above.

6.500 ANALYTICAL PROCEDURES

6.501 Analytical procedures are performed to help the accountant identify relationships and individual items that appear to be unusual. The absence or explanation of unusual relationships or items provides evidence that helps the accountant obtain limited assurance about the financial statements. Paragraph 27 of SSARS No. 1 identifies three major categories of analytical procedures.

Comparing the Financial Statements With Financial Statements for Comparable Prior Period(s)

6.502 These comparisons usually involve comparing significant absolute amounts in the current period financial statement accounts with those same accounts in comparable prior financial statements. For example, the accountant might compare current receivable, inventory, property, revenue, and expense amounts with prior period amounts to determine whether unusual or unexpected differences exist. Analyzing the trends in accounts over two or more periods by computing percentage changes is a common analytical procedure for this type of comparison.

6.503 Such comparisons should be made with comparable prior periods for the procedures to be effective and efficient. In addition, the accountant should consider making these comparisons on a monthly basis or by operating unit or product line to improve their effectiveness in detecting misstatements that occur in one or two months, in operating units, or in product lines.

Practice Tip:

A client may significantly change the nature of its business, making comparisons with financial data from prior periods irrelevant. In such circumstances, you should not waste time making those comparisons. Additional inquiries and other analytical procedures should be performed to provide a basis for the limited assurance provided by your review report.

Comparing the Financial Statements With Anticipated Results

6.504 These comparisons usually involve comparing significant absolute amounts in current period financial statement accounts with budgets or forecasts for those accounts. Of course, budgets or forecasts must be available and the accountant should consider whether they represent realistic objectives before deciding to make these comparisons.

Studying the Relationships of Financial Statement Elements That Would be Expected to Conform to a Predictable Pattern Based on the Entity's Experience

6.505 As an example of this type of analytical procedure, the accountant may expect a change in sales to result in an accompanying change in accounts receivable and cost of sales, and changes in property and equipment to result in accompanying changes in depreciation expense and maintenance and repairs expense.

6.506 These relationships are often analyzed by computing ratios or performing reasonableness tests. Ratios depict the relationship between two financial statement amounts. Reasonableness tests use logical relationships between financial or nonfinancial data to estimate what a financial statement amount or change in such an amount should be. Before studying such relationships, the accountant should consider the potential effect on those relationships of the types of adjustments required in prior periods.

How to Select Analytical Procedures

6.507 The three categories of analytical procedures summarized above are only suggested by SSARS No. 1. The accountant may perform others, such as making comparisons to industry data. Furthermore, SSARS No. 1 does not set forth specific analytical procedures that accountants must perform. Accountants should choose the analytical procedures best suited for reviewing a particular client's financial statements by considering the following factors:

- The specific financial statement assertion to be addressed--existence; completeness; valuation; rights and obligations; or presentation and disclosure.
- The accounts that required adjustments in prior periods (likelihood of misstatement).
- The materiality of the account.
- Prior experience in choosing and applying analytical procedures for a specific client.
- The extent to which a particular item is affected by management's judgment.
- Availability and usefulness of industry statistics.

Practice Tip:

Don't apply analytical procedures mechanically. Identify the analytical procedure that you believe best addresses the relevant financial statement assertion. Comparing amounts over time, calculating trends and ratios, and performing reasonableness tests for the same account is usually too much analytical review. In addition, if an account is not material or the likelihood of misstatement is low, you may not need to apply any analytical procedures to that account.

Practice Tip:

For some engagements, for example, those involving new companies, there is a limited amount of comparable data to perform analytical procedures. In these situations you can always study expected relationships within the current period. In addition, you can always make more inquiries and use scanning of accounting ledgers and journals for unusual items to provide evidence. Also, don't ignore the evidence that is obtained from preparing any accounting schedules that may be necessary to compile the client's financial statements.

Unusual or Unexpected Results

6.508 Before performing analytical procedures, the accountant should determine the extent of changes in amounts, percentages, or relationships that he or she would consider significant. In making this determination the accountant should consider the following factors:

- The extent of changes occurring in prior periods. Some change is likely to be expected based on changed conditions or circumstances.
- Financial statement materiality. Changes should be evaluated in light of the materiality judgment the accountant is using for the financial statements taken as a whole. (See paragraphs 7.114 through 7.117 of Chapter 7 for a discussion of what is material.)
- The nature of the relationship. Some analytical procedures are based on direct, straightforward relationships involving few variables. Other analytical procedures use indirect relationships or involve a number of different variables. Changes identified by direct-relationship analytical procedures are usually more accurate. Therefore, the accountant would be more likely to be concerned about smaller changes from these types of analytical procedures than from the indirect-relationship procedures.

6.509 When the accountant concludes that a change differs significantly from what was expected, the change may be resolved by various actions, including:

- Inquire of appropriate management personnel about why the change occurred.
- Perform other analytical procedures to obtain additional evidence about the reason for the change.
- Develop an explanation for the change that management cannot explain or that other analytical procedures cannot resolve by--
 - Preparing accounting schedules, or
 - Analyzing the detail of specific accounts.

6.510 The Review Engagement Work Program on page 6-31 of the Documentation Assistance section of this chapter presents typical analytical procedures that may be performed in a review. These analytical procedures pertain to common financial statement accounts and areas described in SSARS No. 1. However, as stated in the instructions to the work program, the accountant might decide to omit some analytical procedures or add others based on the factors noted in paragraph 6.507 above.

6.600 QUALITY CONTROL STANDARDS

6.601 As discussed in paragraph 3.402 of Chapter 3, *Statement on Quality Control Standards No. 1* requires a CPA firm to establish a quality control system that provides reasonable assurance that the firm's work will conform with professional standards. To the extent applicable, the accountant should establish policies and procedures related to the nine elements of quality control. Policies requiring the use of standardized forms and checklists for review services (such as those illustrated in this manual) help insure that the firm complies with these quality control requirements.

6.700 DOCUMENTATION

6.701 The following pages include illustrative forms and checklists for review engagements. The Client Acceptance Form, Engagement Letter--Review Engagement, Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements, and Form for Documenting Understanding of Client's

Business and Industry--Supplement for Review Engagement, that were initially presented in Chapter 3, are repeated in this chapter to facilitate reproduction of a documentation package for a review engagement.

Review Engagement Checklist

6.702 The Review Engagement Checklist (page 6-27) is designed to document the planning and performance of the review engagement.

The Work Program

6.703 The Review Engagement Work Program (page 6-31) is designed to document the planning and performance of the inquiry and analytical procedures applied in the review engagement.

Representation Letter

6.704 The Representation Letter--Review Engagement (page 6-45) is designed to document the significant oral representations made by the client to the accountant.

Technical Review Checklist

6.705 The Technical Review Checklist (page 6-47) is designed for CPA firms that require technical review of review engagements to assess the adequacy of the financial statement presentation and disclosure. Such reviews are typically performed by an accountant that was not involved with the engagement.

Signer's Checklist

6.706 The Signer's Checklist (page 6-48) is designed to be completed by the engagement partner to document appropriate performance of the engagement. It also serves to authorize the release of the financial statements and the report.

Financial Statement Control Form

6.707 The Financial Statement Control Form (page 6-49) aids in routing the financial statements and the report through the administrative process. It provides for overall control of the engagement.

Suggested Working Papers

6.708 Table 6-2 on page 6-12 illustrates suggested working papers for documentation of a review engagement.

TABLE 6-2

Suggested Working Papers For Review Engagement

<u>Description</u>	<u>Page</u>
Engagement Letter or Memorandum Describing Understanding with the Client	6-14
Client Acceptance Form	6-16
Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements	6-21
Form for Documenting Understanding of Client's Business and Industry--Supplement for Review Engagement	6-25
Review Engagement Checklist	6-27
Review Engagement Work Program	6-31
Representation Letter--Review Engagement	6-45
Technical Review Checklist (If Required by Firm Policy)	6-47
Signer's Checklist	6-48
Financial Statement Disclosure Checklist	13-38
Financial Statement Control Form	6-49
Trial Balance	
Adjusting and Reclassification Entries	
Results of Inquiries and Analytical Procedures	
Documentation of Any Other Procedures Performed or Other Special Circumstances (e.g., Step-Down to a Lower Level of Service)	

6.800 DOCUMENTATION ASSISTANCE

	<u>Page</u>
Engagement Letter--Review Engagement	6-14
Client Acceptance Form	6-16
Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements	6-21
Form for Documenting Understanding of Client's Business and Industry--Supplement for Review Engagement	6-25
Review Engagement Checklist	6-27
Review Engagement Work Program	6-31
Representation Letter--Review Engagement	6-45
Technical Review Checklist--Compilation and Review Engagements	6-47
Signer's Checklist--Compilation and Review Engagements	6-48
Financial Statement Control Form	6-49

Engagement Letter--Review Engagement

[Date]

Dear _____:

This letter is to confirm my (our) understanding of the terms and objectives of my (our) engagement and the nature and limitations of the services I (we) will provide.

I (We) will perform the following services:

1. I (We) will review the balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. My (Our) review will consist primarily of inquiries of company personnel and analytical procedures (and I (we) will require a client representation letter from you). A review does not contemplate obtaining an understanding of the internal control structure or assessing control risk, tests of accounting records and responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that I (we) will become aware of all significant matters that would be disclosed in an audit. My (Our) engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, I (we) will inform you of any such matters that come to my (our) attention, unless they are clearly inconsequential. I (We) will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and accordingly, I (we) will not express such an opinion on them.

My (Our) report is presently expected to read as follows:

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information

included in these financial statements is the representation of the management of _____ [Client Name].

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, I am (we are) unable to complete my (our) review of your financial statements, I (we) will not issue a report on such statements as a result of this engagement.

2. I (We) will provide your bookkeeper with such consultation on accounting matters as he or she may be required in adjusting and closing the books of account and in drafting financial statements for my (our) review. Your bookkeeper also will provide me (us) with a detailed trial balance and any supporting schedules I (we) require.

My (Our) fees for these services....

I (We) shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me (us).

Sincerely yours,

Acknowledged:

_____ Title

_____ Date

Client Acceptance Form--Part I

Client:

Date:

INSTRUCTIONS:

This form should be completed for all prospective clients for which compilation or review services are to be performed. The data on the form should be reviewed as a basis for initially accepting the client. The form should be updated and reviewed annually as a basis for maintaining an understanding of the client and making decisions about retaining the client.

PART I--BACKGROUND INFORMATION

CLIENT'S LEGAL NAME:

ADDRESS:

PHONE:

FEDERAL I.D. NO.:

STATE I.D. NO.:

1. Describe the nature of the client's business:

2. Identify the type of entity (e.g., proprietorship, partnership, regular corporation, S Corporation, or nonprofit): _____
3. List key owners, officers, and directors of the client:

Name	% Owned	Position

4. Identify any related businesses or individuals:

Name	Nature of Relationship

5. Identify the client's predecessor accountants:

Name:
Address:
Contact person:

6. Did we decide to contact the predecessor accountants? _____

If so, list their comments:

7. Describe the client's relationships with financial institutions:

Name	Type of A/Cs or Loans	Account Executive

8. Describe the services to be provided:

Service	How Often?			Report Deadlines
	Monthly	Quarterly	Annually	

Other Services:

Federal Tax Returns _____

State Tax Returns _____

Payroll Tax Returns _____

_____ Tax returns for principal owners _____

Which ones? _____

9. Will the financial statements and reports be used for high-risk purposes, e.g., to obtain significant amounts of new credit, to obtain performance bonding, or for purchase of the business? _____

Describe use of the financial statements:

10. Does the client have potential going-concern problems? _____

If so, describe them:

11. Describe the client's major sources of financing:

12. Describe any significant engagement performance, accounting or tax problems with which we should be concerned:

13. Describe the billing arrangements:

14. Describe any potential independence problems with respect to the client:

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or Updated by: _____

Reviewed by: (Partner) _____

Client Acceptance Form--Part II

Client: _____

Date: _____

	<u>Yes</u>	<u>No</u>
1. Is there any reason to doubt the integrity of management (owners)?	<input type="checkbox"/>	<input type="checkbox"/>
2. Are we aware of any significant disagreements between management (owners) and the predecessor accountant?	<input type="checkbox"/>	<input type="checkbox"/>
3. Does there appear to be any potential fee collection problems?	<input type="checkbox"/>	<input type="checkbox"/>
4. Are the client's needs beyond our capabilities or staffing abilities?	<input type="checkbox"/>	<input type="checkbox"/>
5. Are we aware of any independence problems that may affect our ability to meet the client's needs?	<input type="checkbox"/>	<input type="checkbox"/>
6. Are there high-risk factors related to the engagement that may affect our decision to accept the client?	<input type="checkbox"/>	<input type="checkbox"/>
7. Is there a potential problem with management (owners) not fully understanding the limitations of the services to be provided (e.g., for the detection of fraud)?	<input type="checkbox"/>	<input type="checkbox"/>

For any "Yes" answers, explain how we plan to mitigate the problem (for example, by assigning more experienced personnel to the engagement, obtaining outside consultants, obtaining a retainer from the client, etc.):

Acceptance Decision:

Yes _____ No _____

Engagement Partner: _____ Date: _____

Concurring Partner: _____ Date: _____

Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements

Client:

Date:

INSTRUCTIONS:

This form should be completed for all compilation and review engagements (other than for personal financial statements). When used in conjunction with the *Client Acceptance Form*, the form provides documentation of the required understanding of the client's business and industry. It should be reviewed and updated annually for any changes in the client's business.

I. INDUSTRY INFORMATION

A. Describe major types of products or services provided by the client:

	% of Volume

B. Describe any sources of information about the client's accounting principles (e.g., AICPA guides, industry publications):

II. ACCOUNTING PRINCIPLES

A. What is the basis of accounting to be used for the financial statements both on an annual and interim basis [GAAP or Other Comprehensive Basis of Accounting (OCBOA)]?

1. Annual financial statements:

2. Interim financial statements:

B. Describe the client's significant accounting policies:

III. ACCOUNTING RECORDS

A. What is the form of the client's accounting records?

<u>Record</u>	<u>Form of the Records</u> <u>Manual/Computer</u>		<u>Personnel Responsible</u>
Journals:			
Cash receipts	M	C	_____
Cash disbursements	M	C	_____
Sales	M	C	_____
Purchases/Voucher	M	C	_____
Payroll	M	C	_____
General	M	C	_____
_____	M	C	_____
_____	M	C	_____
Ledgers:			
General	M	C	_____
Accounts Receivable	M	C	_____
Accounts payable	M	C	_____
Perpetual Inventory	M	C	_____
Physical Inventory Schedule	M	C	_____
_____	M	C	_____
_____	M	C	_____

B. If the client uses accrual basis accounting, describe the client's procedures, if any, for achieving an adequate cut-off of transactions when the financial statements are prepared.

C. If applicable, describe the client's procedures for taking a physical count of its inventory. State how often it is taken.

IV. STATED QUALIFICATIONS OF ACCOUNTING PERSONNEL

<u>Name</u>	<u>Responsibilities</u>	<u>Qualifications</u>

V. OTHER INFORMATION

A. Is there economic dependency on a major customer? _____ If so, describe customer and percent of sales.

B. Describe the nature of any stock plans (e.g., stock options, repurchase, etc.).

C. Describe any transactions with related parties, including the nature of the relationship.

D. Describe any other information that is significant to the engagement.

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or
Updated by:

Reviewed by:
(Partner)

Form for Documenting Understanding of Client's Business and Industry--Supplement for Review Engagement

Client:

Date:

INSTRUCTIONS:

This form should be completed for all review engagements (other than reviews of personal financial statements). When used in conjunction with the *Client Acceptance Form* and the *Form for Documenting Understanding of Client's Business and Industry--Compilation and Review Engagements*, this form provides documentation of the additional required understanding of the client's business and industry required for review engagements. It should be reviewed and updated annually for any changes in the client's business.

I. ORGANIZATION AND PERSONNEL

A. Identify and describe the responsibilities of the chief officers.

<u>Name</u>	<u>Responsibilities</u>

B. Describe the locations at which the client does business and the nature of the activity and number of employees at each location.

C. Describe briefly the compensation methods for each class of employees.

II. OPERATING CHARACTERISTICS

A. Describe the company's sources of revenue, marketing, and distribution methods.

B. Describe the nature of the client's significant assets and liabilities.

C. Describe the nature of the client's significant expenses.

D. Describe the client's production process.

19__ 19__ 19__ 19__ 19__ 19__ 19__

Prepared or Updated by: _____

Reviewed by: (Partner) _____

Review Engagement Checklist

Client: _____

Financial Statement Date: _____

INSTRUCTIONS:

This checklist is a general guide for reviewing annual and interim financial statements of nonpublic companies. Any additional inquiries, analytical procedures, or other procedures performed, and conclusions reached, should also be documented in the working papers. The "N/A" column should be checked for any steps that are not applicable or for steps not required because of immateriality or other reasons. References preceded by "AR" refer to *Statements on Standards for Accounting and Review Services* included in volume 2 of *AICPA Professional Standards*.

<u>PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Prepare or update the Client Acceptance Form.	_____	_____	<input type="checkbox"/>
2. Consider whether the CPA firm is independent of the client. If the firm is not independent, a review report cannot be issued. (AR 100.38)	_____	_____	<input type="checkbox"/>
3. Establish or update an understanding with the client, preferably in writing, regarding the nature of the engagement. Include in the working papers a copy of the engagement letter or a memorandum describing the oral arrangements. (AR 100.08)	_____	_____	<input type="checkbox"/>
4. Consider whether the staffing and scheduling of the engagement is appropriate.	_____	_____	<input type="checkbox"/>
5. Complete or update the Form for Documenting Understanding of Client's Business and Industry-Compilation and Review Engagements.	_____	_____	<input type="checkbox"/>

<u>PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
6. Complete or update the Form for Documenting Understanding of Client's Business and Industry-Supplement for Review Engagement.	_____	_____	<input type="checkbox"/>
7. If the firm was originally engaged to perform a higher level of service, i.e., an audit, document the appropriateness of the decision to change to a review, including a consideration of:			
a. The reason given for the client's request, particularly the implications of a restriction on the scope of the audit, whether imposed by the client or by circumstances.	_____	_____	<input type="checkbox"/>
b. The additional effort required to complete the audit.	_____	_____	<input type="checkbox"/>
c. The estimated additional cost to complete the audit. (AR 100.44-.49)	_____	_____	<input type="checkbox"/>
8. Obtain assurances about the independence of any other accountants engaged to perform segments of the engagement.	_____	_____	<input type="checkbox"/>
9. Consider whether it is necessary to perform any accounting services or to compile financial statements to be able to perform the review. (AR 100.04)	_____	_____	<input type="checkbox"/>
10. Complete the Review Engagement Work Program.	_____	_____	<input type="checkbox"/>
11. Draft the financial statements and review report.	_____	_____	<input type="checkbox"/>
12. Complete the Financial Statement Disclosure Checklist.	_____	_____	<input type="checkbox"/>

<u>PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
13. If the financial statements are prepared using an other comprehensive basis of accounting (OCBOA), consider whether the financial statement titles and disclosure of the basis of accounting are appropriate.	_____	_____	<input type="checkbox"/>
14. Read the financial statements and consider, on the basis of information coming to the accountant's attention, whether the statements appear to conform with generally accepted accounting principles or OCBOA. (AR 100.27)	_____	_____	<input type="checkbox"/>
15. If the financial statements contain a departure from GAAP or OCBOA, including either a measurement or disclosure departure:			
a. Revise the financial statements or modify the review report to indicate the departure.	_____	_____	<input type="checkbox"/>
b. If the financial statements are not revised, consider whether modification of the standard report is adequate to indicate the deficiencies in the financial statements.	_____	_____	<input type="checkbox"/>
c. If modification of the report is not considered adequate, consider withdrawing from the engagement. (AR 100.39-.40)	_____	_____	<input type="checkbox"/>
16. If the financial statements are presented with comparative financial statements for one or more prior periods, determine that all financial statements are appropriately reported on by the CPA firm or a predecessor CPA firm (AR 200.01-.36).	_____	_____	<input type="checkbox"/>

<u>PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
17. If supplementary data accompanies the financial statements, modify the review report to include the other data. (AR 100.43)	_____	_____	<input type="checkbox"/>
18. Include a reference to the review report on each page of the financial statements and supplementary data. (AR 100.34)	_____	_____	<input type="checkbox"/>
19. Date the review report as of the date the inquiry and analytical procedures were completed. (AR 100.33)	_____	_____	<input type="checkbox"/>
20. Obtain a representation letter.	_____	_____	<input type="checkbox"/>
21. Document any other procedures performed or unusual problems and their resolution.	_____	_____	<input type="checkbox"/>
22. Determine that all required forms and checklists have been completed.	_____	_____	<input type="checkbox"/>
23. Determine that all review points by the engagement team and the technical reviewer, if applicable, have been resolved.	_____	_____	<input type="checkbox"/>
24. Other procedures:			
_____	_____	_____	<input type="checkbox"/>
_____	_____	_____	
_____	_____	_____	
_____	_____	_____	

Prepared by: _____
(In-Charge)

Date: _____

Reviewed by: _____
(Partner)

Date: _____

Review Engagement Work Program

Client: _____

Financial Statement Date: _____

PART I--INQUIRIES

INSTRUCTIONS:

The inquiry portion of this Work Program is a general guide for areas about which inquiries should be made in a review of financial statements of a nonpublic entity. The accountant may believe it is necessary to make several specific inquiries to answer one of the questions listed below. When additional inquiries are made, they should also be documented in the working papers.

Each of these inquiries will not necessarily apply to every review engagement. The "N/A" column should be checked for any inquiries that are not applicable. Inquiries may be inapplicable because of: (1) the nature or immateriality of financial statement accounts, (2) the low likelihood of misstatement in an account, (3) knowledge obtained during current or previous engagements, (4) the stated qualifications of entity's accounting personnel, or (5) the extent to which a particular item is affected by management judgment, among other reasons.

	<u>AREA/PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
		<u>Initials</u>	<u>Date</u>	
<u>GENERAL</u>				
1.	Obtain and agree or reconcile general and subsidiary ledgers.	_____	_____	<input type="checkbox"/>
2.	Obtain and foot general ledger trial balance.	_____	_____	<input type="checkbox"/>
3.	Obtain client-prepared financial statements or prepare financial statements and agree or reconcile them to the general ledger or the trial balance.	_____	_____	<input type="checkbox"/>
<u>CASH</u>				
<u>Inquire About</u>				
1.	Accounting principles and policies for cash and the methods of applying them.	_____	_____	<input type="checkbox"/>

	PERFORMED BY		N/A
	Initials	Date	
2. Procedures for recording, classifying, and summarizing cash transactions.	_____	_____	<input type="checkbox"/>
3. Whether bank and book balances have been reconciled.	_____	_____	<input type="checkbox"/>
4. Disposition of old or unusual reconciling items.	_____	_____	<input type="checkbox"/>
5. Whether a proper cash cutoff has been made.	_____	_____	<input type="checkbox"/>
6. Restrictions on cash balances, such as compensating balances.	_____	_____	<input type="checkbox"/>
7. Whether cash funds have been counted and reconciled with control accounts.	_____	_____	<input type="checkbox"/>

RECEIVABLES - ACCOUNTS AND NOTES

Inquire About

1 Accounting principles and policies for receivables and the methods of applying them.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing receivable transactions.	_____	_____	<input type="checkbox"/>
3. Collectibility of receivables.	_____	_____	<input type="checkbox"/>
4. Adequacy of allowance for doubtful accounts and whether uncollectible receivables were written off.	_____	_____	<input type="checkbox"/>
5. Whether interest has been recorded, if applicable.	_____	_____	<input type="checkbox"/>
6. Whether a proper sales cutoff has been made.	_____	_____	<input type="checkbox"/>

	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
7. Whether there are any receivables from employees and related parties.	_____	_____	<input type="checkbox"/>
8. Whether any receivables are pledged, discounted, or factored.	_____	_____	<input type="checkbox"/>
9. Whether receivables are properly classified between current and noncurrent.	_____	_____	<input type="checkbox"/>

INVENTORIES

Inquire About

1. Accounting principles and policies for inventories and the methods of applying them, including the inventory valuation method and proper treatment of material, labor, and overhead, if applicable.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing inventory transactions.	_____	_____	<input type="checkbox"/>
3. Date and methods of performing most recent physical inventory.	_____	_____	<input type="checkbox"/>
4. Whether general ledger control accounts have been adjusted to agree with physical inventories.	_____	_____	<input type="checkbox"/>
5. Procedures for recording changes in inventory between physical inventory date and balance sheet date, if applicable.	_____	_____	<input type="checkbox"/>
6. Consideration of consignments-in and consignments-out.	_____	_____	<input type="checkbox"/>
7. How obsolete or excess inventory has been valued.	_____	_____	<input type="checkbox"/>

	PERFORMED BY		N/A
	Initials	Date	
8. Whether a proper purchase cutoff has been made.	_____	_____	<input type="checkbox"/>
9. Whether any inventory is encumbered.	_____	_____	<input type="checkbox"/>

PREPAID EXPENSES AND OTHER ASSETS

Inquire About

1. Accounting principles and policies for prepaid expenses and other assets and the methods of applying them.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing prepaid expense and other asset transactions.	_____	_____	<input type="checkbox"/>
3. Nature of the items and amounts included in prepaid expenses and other assets, including whether items will benefit future periods.	_____	_____	<input type="checkbox"/>
4. Methods for amortizing prepaid expense and other asset amounts.	_____	_____	<input type="checkbox"/>
5. Whether prepaid expenses and other assets are properly classified between current and non-current.	_____	_____	<input type="checkbox"/>
6. Whether other assets are mortgaged or otherwise encumbered.	_____	_____	<input type="checkbox"/>

INVESTMENTS

Inquire About

1. Accounting principles and policies for investments and the methods of applying them.	_____	_____	<input type="checkbox"/>
---	-------	-------	--------------------------

	PERFORMED BY		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
2. Procedures for recording, classifying, and summarizing investment transactions.	_____	_____	<input type="checkbox"/>
3. Basis used to value investments, including marketable securities, joint ventures, intercompany investments, etc.	_____	_____	<input type="checkbox"/>
4. Whether investment income has been recorded.	_____	_____	<input type="checkbox"/>
5. Whether and how gains and losses on investment sales are recorded.	_____	_____	<input type="checkbox"/>
6. Whether investments are properly classified between current and noncurrent.	_____	_____	<input type="checkbox"/>
7. Whether consolidation or equity requirements have been considered.	_____	_____	<input type="checkbox"/>
8. Whether investments are encumbered.	_____	_____	<input type="checkbox"/>

PROPERTY AND EQUIPMENT

Inquire About

1. Accounting principles and policies for property and equipment and the methods of applying them.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing property and equipment transactions.	_____	_____	<input type="checkbox"/>
3. Basis of valuation, depreciation methods, and criteria for capitalizing property and equipment.	_____	_____	<input type="checkbox"/>
4. Whether and how gains and losses on property and equipment disposals are recorded.	_____	_____	<input type="checkbox"/>

	PERFORMED BY		N/A
	Initials	Date	
5. Whether depreciation and capitalization methods are used consistently.	_____	_____	<input type="checkbox"/>
6. Unrecorded additions or disposals.	_____	_____	<input type="checkbox"/>
7. Whether lease agreements exist and the nature of such leases (capital or operating).	_____	_____	<input type="checkbox"/>
8. Whether property or equipment is mortgaged or otherwise encumbered.	_____	_____	<input type="checkbox"/>

CURRENT LIABILITIES--ACCOUNTS, NOTES, AND ACCRUALS

Inquire About

1. Accounting principles and policies for current liabilities and the methods of applying them.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing current liability transactions.	_____	_____	<input type="checkbox"/>
3. Whether all significant current liabilities have been recorded.	_____	_____	<input type="checkbox"/>
4. Whether all current liabilities are properly classified.	_____	_____	<input type="checkbox"/>
5. Whether there are any collateralized liabilities.	_____	_____	<input type="checkbox"/>
6. Whether there are any current liabilities to employees or related parties.	_____	_____	<input type="checkbox"/>

LONG-TERM LIABILITIES--NOTES, BONDS, AND MORTGAGES

PERFORMED BY

Initials

Date

N/A

Inquire About

- | | | | |
|---|-------|-------|--------------------------|
| 1. Accounting principles and policies for long-term liabilities and the methods of applying them. | _____ | _____ | <input type="checkbox"/> |
| 2. Procedures for recording, classifying, and summarizing long-term liability transactions. | _____ | _____ | <input type="checkbox"/> |
| 3. Maturity dates, interest rates, restrictive covenants, and collateral for long-term liabilities. | _____ | _____ | <input type="checkbox"/> |
| 4. Whether long-term debt is properly classified as noncurrent. | _____ | _____ | <input type="checkbox"/> |
| 5. Whether and how interest expense and capitalized interest have been recorded. | _____ | _____ | <input type="checkbox"/> |

LIABILITIES FOR INCOME AND OTHER TAXES

Inquire About

- | | | | |
|--|-------|-------|--------------------------|
| 1. Accounting principles and policies for income and other taxes and the methods of applying them. | _____ | _____ | <input type="checkbox"/> |
| 2. Procedures for recording, classifying, and summarizing income and other tax liability transactions. | _____ | _____ | <input type="checkbox"/> |
| 3. Whether provision has been made for state and federal income taxes and other taxes payable, such as sales, payroll, franchise, etc. | _____ | _____ | <input type="checkbox"/> |
| 4. Recent or pending federal or state tax authority examinations. | _____ | _____ | <input type="checkbox"/> |
| 5. Whether deferred taxes have been recorded for significant temporary differences. | _____ | _____ | <input type="checkbox"/> |

OTHER LIABILITIES, COMMITMENTS, AND CONTINGENCIES

PERFORMED BY

Initials

Date

N/A

Inquire About

- | | | | |
|---|-------|-------|--------------------------|
| 1. Accounting principles and policies for other liabilities and the methods of applying them. | _____ | _____ | <input type="checkbox"/> |
| 2. Procedures for recording, classifying, summarizing other liability transactions. | _____ | _____ | <input type="checkbox"/> |
| 3. Nature and amounts of other liabilities. | _____ | _____ | <input type="checkbox"/> |
| 4. Whether other liabilities have been properly classified between current and noncurrent. | _____ | _____ | <input type="checkbox"/> |
| 5. Whether obligations under any profit-sharing or bonus plans have been accrued. | _____ | _____ | <input type="checkbox"/> |
| 6. Whether there are any contingent liabilities, such as discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims. | _____ | _____ | <input type="checkbox"/> |
| 7. Whether there are any unasserted claims. | _____ | _____ | <input type="checkbox"/> |
| 8. Whether there are any commitments to purchase or sell company equity or debt securities. | _____ | _____ | <input type="checkbox"/> |
| 9. Whether there are any commitments to purchase, sell, or construct real property. | _____ | _____ | <input type="checkbox"/> |

EQUITY

Inquire About

- | | | | |
|--|-------|-------|--------------------------|
| 1. Accounting principles and policies for equity and the methods of applying them. | _____ | _____ | <input type="checkbox"/> |
|--|-------|-------|--------------------------|

	PERFORMED BY		N/A
	Initials	Date	
2. Procedures for recording, classifying, and summarizing equity transactions.	_____	_____	<input type="checkbox"/>
3. The nature of any changes in equity accounts.	_____	_____	<input type="checkbox"/>
4. What classes of capital stock are authorized, number of shares issued and outstanding for each class, and their par or stated value.	_____	_____	<input type="checkbox"/>
5. Whether amounts of outstanding shares of capital stock agree with subsidiary records.	_____	_____	<input type="checkbox"/>
6. Whether capital stock preferences, if any, have been disclosed.	_____	_____	<input type="checkbox"/>
7. Whether stock options have been granted and the nature and terms of such options.	_____	_____	<input type="checkbox"/>
8. Whether there are any treasury stock transactions.	_____	_____	<input type="checkbox"/>
9. Whether there are any restrictions or appropriations of retained earnings.	_____	_____	<input type="checkbox"/>

REVENUES AND EXPENSES

Inquire About

1. Accounting principles and policies for revenues and expenses and the methods of applying them.	_____	_____	<input type="checkbox"/>
2. Procedures for recording, classifying, and summarizing revenue and expense transactions.	_____	_____	<input type="checkbox"/>
3. Whether sales, purchase, and expense cutoffs are proper.	_____	_____	<input type="checkbox"/>

	PERFORMED BY		N/A
	Initials	Date	
4. Whether there are discontinued operations or other items that might be considered extraordinary.	_____	_____	<input type="checkbox"/>

OTHER**Inquire About**

1. Whether any events have occurred after the balance sheet date that have a significant effect on the financial statements.	_____	_____	<input type="checkbox"/>
2. Whether any actions taken at stockholder, board of directors, or comparable meetings that affect the financial statements have been properly recorded or disclosed.	_____	_____	<input type="checkbox"/>
3. Whether material transactions with related parties have occurred and whether they are properly disclosed.	_____	_____	<input type="checkbox"/>

PART II--ANALYTICAL PROCEDURES

INSTRUCTIONS:

The analytical procedures portion of this Work Program is a general guide for analytical procedures that may be performed in a review of financial statements of a nonpublic entity. The accountant may feel that additional analytical procedures are necessary in some areas. When additional analytical procedures are performed, they should also be documented in the working papers.

Each of these analytical procedures will not necessarily apply to every review engagement. The "N/A" column should be checked for any inquiries that are not applicable. Inquiries may be inapplicable because of the (1) nature or immateriality of financial statement accounts, (2) low likelihood of misstatement in an account, (3) knowledge obtained during current or previous engagements, (4) stated qualifications of entity's accounting personnel, (5) extent to which a particular item is affected by management judgment, among other reasons.

<u>AREA/PROCEDURE</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
<u>GENERAL</u>			
1. Compare amounts in each significant account in the current financial statements with amounts for comparable prior period(s).	_____	_____	<input type="checkbox"/>
2. Compare amounts in each significant account in the current financial statements with budgeted or forecasted amounts for the current period.	_____	_____	<input type="checkbox"/>
3. Scan selected journals and ledgers.	_____	_____	<input type="checkbox"/>
4. Based on the results of steps 1, 2 and 3 above, identify unusual fluctuations or relationships and document management's explanation for them.	_____	_____	<input type="checkbox"/>

Specific Accounts: For each significant account below, select and compute the analytical procedure(s) appropriate for this review engagement and compare the results with prior periods. The analytical procedures not considered necessary should be marked "N/A" and any additional analytical procedures performed should be documented.

<u>CASH</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Current Ratio (Current Assets/Current Liabilities)	_____	_____	<input type="checkbox"/>
2. Quick Ratio (Current Assets - Inventory / Current Liabilities)	_____	_____	<input type="checkbox"/>
 <u>RECEIVABLES--ACCOUNTS AND NOTES</u>			
1. Number of Days' Sales in Ending Accounts Receivable (Average Net Receivables X 360 / Net Credit Sales)	_____	_____	<input type="checkbox"/>
2. Bad Debts Expense as a Percent of Net Sales (Bad Debts Expense / Net Credit Sales)	_____	_____	<input type="checkbox"/>
3. Allowance for Doubtful Accounts as a Percent of Accounts Receivable (Allowance / Ending Receivables)	_____	_____	<input type="checkbox"/>

	<u>PERFORMED BY</u>		
	<u>Initials</u>	<u>Date</u>	<u>N/A</u>
4. Aged Accounts Receivable (Percent of Ending Receivables in following categories)			
0 - 30 days			
31 - 60 days			
61 - 90 days			
91 - 120 days			
Over 120 days	_____	_____	<input type="checkbox"/>

INVENTORIES

1. Gross Margin as a Percent of Net Sales (Gross Margin / Net Sales)	_____	_____	<input type="checkbox"/>
2. Inventory Turnover (Cost of Sales / Average Inventory)	_____	_____	<input type="checkbox"/>

INVESTMENTS

1. Rate of Return on Major Investment Classes (Investment Income / Average Investment)	_____	_____	<input type="checkbox"/>
---	-------	-------	--------------------------

<u>PROPERTY AND EQUIPMENT</u>	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Depreciation Expense as a Percent of Major Property and Equipment Classes (Depreciation Expense / Property & Equipment)	_____	_____	<input type="checkbox"/>
2. Accumulated Depreciation as a Percent of Major Property and Equipment Classes (Accumulated Depreciation / Property & Equipment)	_____	_____	<input type="checkbox"/>
3. Repair and Maintenance Expense as a Percent of Property and Equipment (Repair & Maintenance Expense / Property & Equipment)	_____	_____	<input type="checkbox"/>

LONG-TERM LIABILITIES--NOTES, BONDS, AND MORTGAGES

1. Interest Expense as a Percent of Major Classes of Average Long-Term Liabilities (Interest Expense / Average Long-Term Liabilities)	_____	_____	<input type="checkbox"/>
2. Long-term Debt to Equity (Long-Term Liabilities / Total Equity)	_____	_____	<input type="checkbox"/>

OTHER

_____	_____	_____	<input type="checkbox"/>
_____	_____	_____	
_____	_____	_____	

Prepared by: _____ Date: _____
(In-Charge)

Reviewed by: _____ Date: _____
(Partner)

Representation Letter - Review Engagement

[Date of Accountant's Report]

[To the Accountant]

In connection with your review of the balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings, and cash flows for the _____ [Period] then ended, for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles (or other comprehensive basis of accounting), we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and cash flows of (name of client) in conformity with generally accepted accounting principles.* In that connection, we specifically confirm that--
 - a. The Company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
 - b. There have been no changes during the year in the Company's accounting principles and practices.
 - c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
 - d. There are no material transactions that have not been properly reflected in the financial statements.
 - e. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
 - f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other

material liabilities or gain or loss contingencies that are required to be accrued or disclosed.

- g. The Company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
 - h. There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
 - i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
 - j. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies) that may affect the financial statements.
 3. We have responded fully to all inquiries made to us by you during your review.

[Name of Owner or Chief Executive Officer and Title]

[Name of Chief Financial Officer and Title, where applicable]

Note:

- * This representation letter should be modified when the financial statements are prepared in accordance with an other comprehensive basis of accounting. (See Chapter 9.)

Technical Review Checklist--Compilation and Review Engagements

Client: _____

Financial Statement Date: _____

Technical Reviewer: _____ Date: _____

INSTRUCTIONS:
This form should be completed by the technical reviewer on those engagements specified by the CPA firm's quality control policies and procedures.

Initials

- 1. Review the financial statements for appropriate form and content. Consider the appropriateness of:
 - a. Titles.
 - b. Captions.
 - c. Classifications within captions.
 - d. Descriptions.
 - e. Reference to Accountant's Report and financial statement notes.
 - 2. Compare the Financial Statement Disclosure Checklist to the notes to the financial statements. Consider whether the notes are complete and worded appropriately.
 - 3. Review the financial statements for any obvious departures from GAAP or OCBOA.
 - 4. Review the engagement checklists:
 - a. To determine that they have been completed.
 - b. For potential problems.
 - 5. Describe any problems noted and the way they were resolved.
- _____
- _____

Signer's Checklist--Compilation and Review Engagements

Client: _____

Financial Statement Date: _____

Partner: _____

Date: _____

INSTRUCTIONS:

This form should be completed by the engagement partner for all compilation and review engagements. The form is designed to document performance of the engagement in accordance with the firm's quality control policies and procedures, and to authorize the release of the financial statements and the report.

INITIALS

1. I have reviewed the Compilation (Review) Work Program.
2. I have reviewed the Technical Review Checklist, if applicable.
3. I have reviewed the financial statements for appropriate form and departures from GAAP or OCBOA.
4. I have reviewed the accountant's report.
5. I authorize issuance of the financial statements and the report.

Financial Statement Control Form

Client: _____

Financial Statement Date: _____

SERVICE PERFORMED:

COMPILATION

REVIEW

	<u>PERFORMED BY</u>		<u>N/A</u>
	<u>Initials</u>	<u>Date</u>	
1. Submit financial statements and report to typing.	_____	_____	<input type="checkbox"/>
2. Proofread the financial statements and report.	_____	_____	<input type="checkbox"/>
3. Resubmit the financial statements and report for correction.	_____	_____	<input type="checkbox"/>
4. Submit to technical reviewer, if applicable.	_____	_____	<input type="checkbox"/>
5. Resubmit the financial statements and report for corrections.	_____	_____	<input type="checkbox"/>
6. Submit to engagement partner for final review.	_____	_____	<input type="checkbox"/>
7. Release the financial statements and report.	_____	_____	<input type="checkbox"/>

Number of Copies:

Bound: _____ Unbound: _____

Other: _____

CHAPTER 7
REPORTING ON FINANCIAL STATEMENT REVIEW ENGAGEMENTS

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CHAPTER 7

REPORTING ON FINANCIAL STATEMENT REVIEW ENGAGEMENTS

7.000 THE STANDARD REVIEW REPORT

7.001 Paragraph 32 of SSARS No. 1 states that financial statements reviewed by an accountant should be accompanied by a report that states--

- a. A review was performed in accordance with standards established by the American Institute of Certified Public Accountants. (The exposure draft of SSARS No. 7 (as summarized in Chapter 1) proposes to change this reference to standards in the report to read as follows "Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants." Users of this manual should determine the status of this exposure draft when drafting review reports.)
- b. All information included in the financial statements is the representation of management (owners) of the entity.
- c. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data.
- d. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion on the financial statements taken as a whole and, accordingly, no such opinion is expressed.
- e. The accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles (or an other comprehensive basis of accounting, other than those modifications, if any, indicated in the report.

7.002 The report should not describe any other procedures performed as part of the review engagement because users may place undue reliance on such procedures. The report ordinarily should be addressed to the board of directors, stockholders, partners, general partner, or proprietor of the client. (See page 7-17 in the Sample Review Reports section of this chapter for an illustrative standard review report.)

7.003 Each page of the financial statements and any accompanying supplementary information should include a reference to the accountant's report, such as "See Accountant's Review Report."

7.004 The date of completion of the accountant's inquiry and analytical procedures should be used as the date of the review report.

Reporting When the Accountant Is Not Independent

7.005 Paragraph 38 of SSARS No. 1 prohibits an accountant from issuing a review report when he or she is not independent.

Practice Tip:

Accountants often overlook the effect of past-due fees on the CPA firm's independence. If the CPA firm has not been paid for the prior year's review (or compilation) fee, the firm is not independent and a review report cannot be issued. (See paragraphs 3.004 through 3.007 of Chapter 3 for a more detailed discussion of the conditions that impair the accountant's independence.)

Reporting on Financial Statements That Omit Substantially All Disclosures

7.006 The accountant is not permitted to issue a review report containing the broad statement that management has elected to omit substantially all disclosures. SSARS No. 1, Interpretation No. 1, *Omission of Disclosures in Reviewed Financial Statements*, states that such a report modification may be used only in a compilation engagement, not a review. When disclosures are omitted from reviewed statements, regardless of the number of omitted disclosures, the review report must include the omitted disclosures when the required information is known. Otherwise, the report must identify the nature of each omitted disclosure.

Practice Tip:

Modifying a review report for financial statements that omit substantially all disclosures is impractical. You should not accept such engagements. Instead, the client should be counseled to issue full disclosure financial statements or change to a compilation service. However, see paragraphs 3.303 through 3.308 of Chapter 3 before accepting a change to a compilation engagement.

Reporting on the Review of Only One Financial Statement

7.007 An accountant may be engaged to review and report on only one basic financial statement, for example, only the balance sheet. SSARS No. 1 allows the accountant to perform such a service so long as the scope of the accountant's inquiry and analytical procedures has not been restricted.

7.008 The accountant's review report on only one financial statement should refer only to that statement. Also, the financial statement should be accompanied by all of the notes relevant to that statement. (See page 7-18 of the Sample Review Reports section of this chapter for an illustrative report.)

7.100 MODIFICATIONS TO THE STANDARD REVIEW REPORT

Reporting When the Statement of Cash Flows Is Omitted

7.101 Generally accepted accounting principles (FASB Statement No. 95, *Statement of Cash Flows*) requires presentation of a statement of cash flows for each period that a balance sheet and an income statement are presented. Therefore, omission of the statement of cash flows from the financial statements of a profit-oriented business constitutes a departure from GAAP that must be indicated in the accountant's review report. (See page 7-19 in the Sample Review Reports section of this chapter for an illustrative report.)

7.102 There are, however, exceptions to this requirement. Unless specifically requested, a statement of cash flows is not required when financial statements are presented in prescribed forms or as a special purpose financial presentations in compliance with contractual agreements or regulatory requirements. In addition, a statement of cash flows is not required for OCBOA or personal financial statements, and when only one financial statement (e.g., a balance sheet or income statement) is

presented. (See page 7-18 in the Sample Review Reports section of this chapter for an illustrative report.)

Reporting on Financial Statements With Departures From GAAP

7.103 An accountant who is engaged to review financial statements may become aware of departures from GAAP or OCBOA that are material to the financial statements. In these circumstances the following three options are available to the accountant:

- Convince the client to revise the financial statements.
- Modify the review report to disclose the departure.
- Withdraw from the engagement. (See paragraph 7.108.)

If the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departures. SSARS No. 1, Interpretation No. 6, *Withdrawal from Compilation and Review Engagements*, states that modification of the accountant's report is ordinarily adequate to indicate the deficiencies in the financial statements. However, in rare circumstances, the nature, extent, and probable effect of the departures from GAAP or OCBOA might cause the accountant to question whether the departures were undertaken with the intention of misleading financial statement users. In those circumstances, withdrawal from the review engagement might be necessary; however, the accountant ordinarily would not decide to withdraw when the client agrees that the effects of the departures should be determined and disclosed in the accountant's report.

7.104 If the accountant decides that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph added to the review report. The paragraph should include a description of the effects of the departure on the financial statements if management has determined them, or they are known to the accountant based on the inquiry and analytical procedures performed. The accountant is not required to determine the effects of the departure if the client has not done so, but the fact that the effects of the departure have not been determined should be disclosed in the accountant's report. (See pages 7-20 and 7-21 in the Sample Review Reports section of this chapter for illustrative reports.)

7.105 **Reporting When There Are Significant Departures From GAAP.** Occasionally, the accountant may review financial statements that contain significant and pervasive departures from GAAP or OCBOA. In these circumstances, the accountant should not state in his or her report an overall conclusion that the financial statements are not presented in accordance with GAAP or OCBOA. To do so would

be equivalent to expressing an adverse opinion on the financial statements taken as a whole. Such an opinion is only appropriate when the accountant has audited the financial statements.

7.106 When the financial statements contain departures that are significant and pervasive, the accountant may wish to emphasize the limitations of the financial statements in a separate paragraph, such as the one presented below:

Because the significance and pervasiveness of the matters discussed above makes it difficult to assess their impact on the financial statements taken as a whole, users of these financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in conformity with generally accepted accounting principles.

7.107 Inclusion of this emphasizing paragraph in the accountant's review report is not a substitute for disclosure of the specific departures and their effects on the financial statements when the effects have been determined.

7.108 If the accountant decides that modification of the standard report is not sufficient to disclose the deficiencies of the financial statements taken as a whole, the accountant should withdraw from the engagement and provide no further services with respect to that set of financial statements. The accountant may also want to consult with his or her attorney.

7.109 What Is GAAP? When evaluating whether a particular accounting principle used by a client is generally accepted, the accountant may refer to a variety of sources from Statements of the Financial Accounting Standards Board or the Governmental Accounting Standards Board to articles in accounting journals. While there is no official list of accounting principles, SAS No. 69, *The Meaning of "Present Fairly in Conformity With generally Accepted Accounting Principles" in the Independent Auditor's Report*, provides guidance on the levels of authority of various sources of GAAP. The Statement divides the sources of GAAP into the following five categories:

1. Accounting principles promulgated by a body designated by the AICPA Council to establish such principles, pursuant to rule 203 of the AICPA *Code of Professional Conduct*. Rule 203 provides that a CPA should not (1) express an unqualified opinion on financial statements or (2) state that he or she is not aware of any material modifications that should be made to financial statements, if such statements contain a material departure from such pronouncements unless, due to unusual circumstances, adherence to the pronounce-

ments would make the statements misleading. Rule 203 implies that application of officially established accounting principles almost always results in the fair presentation of financial position, results of operations, and cash flows, in conformity with generally accepted accounting principles. Nevertheless, rule 203 provides for the possibility that literal application of such a pronouncement might, in unusual circumstances, result in misleading financial statements.

2. Pronouncements of bodies, composed of expert accountants, that deliberate accounting issues in public forums for the purpose of establishing accounting principles or describing existing accounting practices that are generally accepted, provided those pronouncements have been exposed for public comment and have been cleared by a body referred to in category (1).
3. Pronouncements of bodies, organized by a body referred to in category (1) and composed of expert accountants, that deliberate accounting issues in public forums for the purpose of interpreting or establishing accounting principles or describing existing accounting practices that are generally accepted, or pronouncements referred to in category (2) that have been cleared by a body referred to in category (1) but have not been exposed for public comment.
4. Practices or pronouncements that are widely recognized as being generally accepted because they represent prevalent practice in a particular industry, or the knowledgeable application to specific circumstances of pronouncements that are generally accepted.
5. Other accounting literature.

7.110 In contrast to prior guidance on sources of GAAP, this represents a true hierarchy from the highest level, (1), to the lowest level, (5). If the accounting treatment of a particular transaction or event is not specified by a pronouncement included in category (1), the accountant should consider whether the accounting treatment is specified by another source of accounting principles. In situations in which there is a conflict between the accounting treatment suggested by sources from different categories, the guidance in the higher category should be followed, or the accountant should be prepared to justify use of the guidance included in the lower category.

7.111 Most of the pronouncements or practices in categories (2), (3), and (4) had equal authoritative standing prior to the issuance of SAS No. 69. Therefore, SAS No. 69 contains a transition rule; clients following appropriate accounting principles before the effective date of the Statement need not change to an accounting principle of higher authority simply as a result of issuance of the SAS No 69. Specifically, a client following an accounting treatment in category (3) or (4) as of March 15, 1992

(March 15, 1993 for Emerging Issues Task Force (EITF) Consensuses), need not change to an accounting treatment contained in a category (2) or a category (3) pronouncement whose effective date is before March 15, 1992 (March 15, 1993 for EITF Consensuses). For accounting pronouncements with effective dates after March 15, 1992 (March 15, 1993 for EITF Consensuses), and for clients initially applying an accounting principle after March 15, 1992 (March 15, 1993 for EITF Consensuses), the accountant should follow the new hierarchy.

7.112 Table 7-1 summarizes the pronouncements are that included in each of the five categories of GAAP for nongovernmental entities and for state and local governments.

Table 7-1

GAAP HIERARCHY SUMMARY

Nongovernmental Entities	State and Local Governments
Category 1	
FASB Statements and Interpretations, APB Opinions, and AICPA Accounting Bulletins	GASB Statements and Interpretations, plus AICPA and FASB pronouncements if made applicable to state and local governments by a GASB Statement or Interpretation
Category 2	
FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and AICPA Statements of Position	GASB Technical Bulletins, and the following pronouncements if specifically made applicable to state and local governments by the AICPA: AICPA Industry Audit and Accounting Guides and AICPA Statements of Position
Category 3	
Consensus positions of the FASB Emerging Issues Task Force and AICPA Practice Bulletins	Consensus positions of the GASB Emerging Issues Task Force and AICPA Practice Bulletins if specifically made applicable to state and local governments by the AICPA
Category 4	
AICPA accounting interpretations, "Qs and As" published by the FASB staff, as well as industry practices widely recognized and prevalent	"Qs and As" published by the GASB staff, as well as industry practices widely recognized and prevalent
Category 5	
Other accounting literature, including FASB Concepts Statements; AICPA Issues Papers; APB Statements; International Accounting Standards Committee Statements; GASB Statements, Interpretations, and Technical Bulletins; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles	Other accounting literature, including GASB Concepts Statements; pronouncements in categories (1) through (4) of the hierarchy for nongovernmental entities when not specifically made applicable to state and local governments; APB Statements; FASB Concepts Statements; AICPA Issues Papers; International Accounting Standards Committee Statements; pronouncements of other professional associations or regulatory agencies; AICPA Technical Practice Aids; and accounting textbooks, handbooks, and articles

7.113 Departures From Promulgated Accounting Principles That Prevent the Financial Statements From Being Misleading. Rule 203 of the AICPA *Code of Professional Conduct* generally prohibits a CPA from issuing an unqualified audit opinion or an unmodified review report on financial statements that depart from promulgated GAAP (i.e., category (1) in Table 7-1). However, if the CPA can demonstrate that due to unusual circumstances the financial statements (that contain the departure) would be materially misstated if they applied the promulgated principle, the CPA can comply with Rule 203 by describing the departure, its approximate effects, if practicable, and the reasons why compliance with the principle would result in misleading financial statements. The CPA may then issue an unqualified audit opinion, or state in a review report that he or she is not aware of any material modifications that should be made to such statements in order for them to be in conformity with GAAP.

7.114 What Is Material? Accountants should not issue an unmodified review report on financial statements that contain material deficiencies. The term *material* may be defined as "sufficiently important to influence decisions made by reasonable users of financial statements." Evaluating whether a departure from GAAP or OCBOA is material involves professional judgment.

7.115 Materiality depends on both the dollar amount and the nature of the item. For example, an amount that is material to the income statement might not be material if it only affects the client's balance sheet. In addition, a lower level of materiality is typically applied to the disclosure of related party transactions than is applied to other items in the financial statements.

7.116 Accountants agree that materiality is relative rather than absolute. As clients increase in size, amounts that are material to their financial statements also increase. Therefore, materiality guidelines generally are specified as a percentage of some base, such as net income before taxes, total revenues, or total assets. A common rule of thumb for materiality is 5 to 10 percent of income before taxes. Some accountants apply this rule such that 5 percent of normal net income before taxes is considered immaterial, above 10 percent is considered material. For departures between 5 and 10 percent, judgment is applied.

7.117 Some accountants use a sliding scale percentage of total assets or total revenues to determine materiality. The following is an example of such guidelines:

Materiality Base (Total Assets or Revenues)	Percentage
Up to \$50,000	5.0%
Above \$50,000 to \$100,000	4.0%
Above \$100,000 to \$300,000	3.5%
Above \$300,000 to \$1,000,000	2.5%
Above \$1,000,000 to \$3,000,000	1.5%
Above \$3,000,000 to \$10,000,000	1.0%

Reporting on Uncertainties

7.118 Financial Statements presented in accordance with GAAP or OCBOA should disclose information about significant uncertainties affecting the client's financial statements, including those related to the client's ability to continue as a going concern. As long as the accountant believes that disclosures about uncertainties are adequate, there is no need to modify the review report. The accountant, however, may decide to add a paragraph to his or her report to emphasize those uncertainties. (See page 7-22 in the Sample Review Reports section of this chapter for an illustrative report.)

7.119 Uncertainties are matters that (1) may affect the client's financial statements, (2) will be resolved by the occurrence of some future event, and (3) are not susceptible of reasonable estimation by management. Examples of uncertainties include litigation against the client, governmental and regulatory actions, contracts under renegotiation or dispute, and tax disputes when precedents are not clear.

7.120 Uncertainties should not be confused with accounting estimates. Matters whose outcomes depend on the actions of management and relate to typical business operations generally are susceptible to reasonable estimation. Therefore, they are estimates inherent in the accounting process and not uncertainties. Examples of these matters include estimates of uncollectible receivables, warranty obligations, income taxes, and inventory losses due to obsolescence. Estimation of these matters is required for the financial statements to be in accordance with GAAP. The accountant should treat the matter as a GAAP departure if an estimate is not made, or the accountant believes that management's estimate is unreasonable.

7.121 FASB Statement No. 5, *Accounting for Contingencies*, describes the

accounting for the most common type of uncertainties, loss contingencies. This Statement divides loss contingencies into three types based on the probability of unfavorable outcome, and provides the following guidance about accounting for them:

- Contingent losses should be accrued and recorded in the financial statements if (1) information available prior to the issuance of the financial statements indicates that it is probable that a loss has been sustained at the balance sheet date, and (2) the amount of the loss can be reasonably estimated.
- Contingent losses that do not meet the above criteria should be disclosed in the notes to the financial statements when occurrence of the loss is at least reasonably possible.
- Contingent losses need not be disclosed when occurrence of the loss is remote, with the exception of those that are traditionally disclosed, such as guarantees of indebtedness of others, and guarantees to repurchase receivables that have been sold.

7.122 Disclosure in the notes to the financial statements of a loss contingency should include the nature of the contingency and give an estimate of the possible loss (or range of loss) or state that such an estimate cannot be made. When considering the adequacy of disclosures about loss contingencies in reviewed financial statements, the accountant should look to the guidance in FASB Statement No. 5.

7.123 **Uncertainty About Ability to Continue As a Going Concern.** A special type of significant uncertainty is the ability of a client to continue as a going concern. Conditions that might cause the accountant to question whether there is a significant uncertainty about the client's ability to continue as a going concern include matters such as negative cash flows from operations, defaults on loan agreements, adverse financial ratios, work stoppages, and legal or regulatory proceedings.

7.124 The accountant's obligation is the same for a going-concern uncertainty as for other uncertainties--the adequacy of financial statement disclosures must be considered. Provided the financial statements appropriately disclose the uncertainty, the accountant is not required to modify his or her report. The accountant may, however, elect to add a separate emphasis-of-a-matter paragraph to his or her review report that discusses a going concern uncertainty. (See page 7-23 in the Sample Review Reports section of this chapter for an illustrative report.)

7.125 Although FASB Statement No. 5 contains guidance about disclosures for uncertainties in general, it does not address specific disclosure requirements for going concern uncertainties. Such guidance has been developed by the AICPA's auditing standards board for auditors and is included in SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. SSARS No. 1,

Interpretation No. 11, *Reporting on Uncertainties*, requires accountants to consider the disclosure guidance for going concern uncertainties in paragraphs 10 and 11 of SAS No. 59 when performing compilation and review engagements. SAS 59 No. indicates that the following types of information about the uncertainty might be disclosed:

- Pertinent conditions and events giving rise to substantial doubt about the entity's ability to continue as a going concern
- The possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations
- Management's plans, including consideration of any relevant prospective information
- Information about the recoverability or classification of recorded asset amounts or the amounts or classification of liabilities

7.126 Accountant's Responsibility to Identify Going Concern Problems. The preceding discussion assumes the accountant is already aware of a going concern problem. Many accountants have questioned whether they are required, in a review engagement, to look for conditions that indicate a going concern problem. The authors believe that, although there is no such requirement, accountants should be alert for conditions that raise doubts about the client's ability to continue to operate. As mentioned in Paragraph 7.125, if such a conditions are identified, the accountant should refer to SAS No. 59 for guidance on evaluating the potential going concern problem and the disclosure required, if any. In other words, even though there is no requirement to look for a going concern problem, if the accountant discovers a problem during the course of the engagement, he or she should consider its effects on the financial statements.

Reporting on Inconsistencies

7.127 Reporting on inconsistencies in the application of acceptable accounting principles in a review engagement is similar to reporting on uncertainties. When the financial statements adequately disclose such inconsistencies, the accountant is not required to modify his or her review report. APB Opinion No. 20, *Accounting Changes*, provides guidance about the accounting treatment and disclosure of changes in accounting principles. (See paragraphs 13.102 through 13.108 of Chapter 13 for a discussion of these accounting requirements.)

Scope Limitations

7.128 Paragraph 36 of SSARS No. 1 states that when the accountant is unable to perform the inquiry or analytical procedures he or she considers necessary to achieve limited assurance in a review engagement, a review report cannot be issued. Thus, a review report modified for a scope limitation is never an appropriate report. In addition, the exposure draft of SSARS No. 7, which proposes requiring the accountant to obtain a representation letter in a review engagement, would consider the failure to obtain such a letter to be a scope limitation. (See Chapter 1 for a summary of the exposure draft.)

7.129 When a scope limitation exists in a review engagement, the accountant may be able to perform a compilation service and issue a compilation report. Before deciding to change the level of service in such circumstances, the accountant should refer to paragraphs 3.306 through 3.308 of Chapter 3 and to paragraphs 44 through 49 of SSARS No. 1.

Practice Tip:

The authors believe that when a client-imposed scope limitation exists in a review engagement, the accountant should not accept a change to a compilation engagement. Such limitations raise questions about the matters to which the scope limitation applies that would continue to exist in the compilation engagement. If, however, the scope limitation stems from circumstances beyond the client's control, such as accounting records being destroyed by fire, the accountant should consider changing to a compilation.

Reporting When Supplementary Information Accompanies the Reviewed Financial Statements

7.130 When supplementary information accompanies reviewed financial statements, the accountant may either compile or review that information. The accountant reviews supplementary information by applying inquiry and analytical procedures to it. When the information has been reviewed, paragraph 43 of SSARS No. 1 specifies that the accountant should report on that information either in his or her review report on the basic financial statements or in a separate report accompanying the supplementary information.

7.131 The report on reviewed supplementary information should state the following:

- A 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.
- The supplementary information is presented only for analysis purposes and has been subjected to the inquiry and analytical procedures applied to the financial statements.
- The accountant did not become aware of any material modifications that should be made to the supplementary information. (See page 7-24 of the Sample Review Reports section of this chapter for an illustrative report.)

7.132 If the supplementary information has not been reviewed, the accountant's report should state the following:

- A 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.
- The supplementary information is presented only for analysis purposes and has not been subjected to the inquiry and analytical procedures applied to the financial statements.
- The supplementary information has been compiled from information that is the representation of management, and the accountant does not express an opinion or any other form of assurance on such information. (See page 7-25 of the Sample Review Reports section of this chapter for an illustrative report.)

Subsequent Discovery of Facts About a Reviewed Financial Statement

7.133 Subsequent to the date of the review report, the accountant may become aware of facts that may have existed at the report date which might have caused the accountant to believe that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory. Paragraph 42 of SSARS No. 1 indicates that in those circumstances, the accountant may wish to consider the guidance in SAS No. 1, section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report*, in determining the appropriate course of action. Because of the legal implications involved, the accountant should consider consulting his or her attorney.

7.200 SAMPLE REVIEW REPORTS

7.201 The following pages include illustrative reports for various review engagement reporting situations.

7.202 As discussed in Chapter 1, an exposure draft of SSARS No. 7 has been issued that proposes a change to the standard review report. The illustrative review reports in this chapter do not reflect this proposed change, because, if adopted, the change will not be effective before 1993. However, users of this manual should be alert for issuance of the final statement.

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Standard Review Report

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

(Firm's signature)

_____ [Report Date]

Note:

This reporting guidance assumes that a combined statement of income and retained earnings is presented. If a separate statement of retained earnings is presented, the report should be worded as follows:

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date] and the related statements of income, retained earnings, and cash flows for the _____ [Period] then ended,...

Review Report--Balance Sheet Only

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], in accordance with standards established by the American Institute of Certified Public Accountants. All information included in this balance sheet is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying balance sheet in order for it to be in conformity with generally accepted accounting principles.

(Firm's signature)

_____ [Report Date]

Review Report--Statement of Cash Flows Omitted

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statement of income and retained earnings for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

A statement of cash flows for the _____ [Period] ended _____ [Financial Statement Date] has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

(Firm's signature)

_____ [Report Date]

Review Report--GAAP Departure With Effect Not Determined

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As discussed in Note __ to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows have not been determined.

(Firm's signature)

_____ [Report Date]

Review Report--GAAP Departure With Effect Determined

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter discussed in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As disclosed in Note __ to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has (The owners have) informed me (us) that the Company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have decreased by \$500,000.

(Firm's signature)

_____ [Report Date]

Review Report--Emphasis of an Uncertainty

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As discussed in Note __ to the financial statements, the Company is currently a defendant in a lawsuit alleging sale of a defective product and claiming compensating and punitive damages. The Company has filed a counteraction, and preliminary hearings and discovery proceedings on both actions are in process. The ultimate outcome of the lawsuit cannot be presently determined. Accordingly, no provision for any liability that may result upon adjudication has been made in the accompanying financial statements.

(Firm's signature)

_____ [Report Date]

Review Report--Emphasis of a Going Concern Uncertainty

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As discussed in Note __ to the financial statements, certain conditions indicate that the Company may not be able to continue as a going concern. The accompanying financial statements do not include any adjustments that might be necessary should the Company be unable to continue as a going concern.

(Firm's signature)

_____ [Report Date]

Review Report--Supplementary Information Subjected to Review Procedures

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

My (Our) review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in Schedules _____ is presented only for supplementary analysis purposes. This information has been subjected to the inquiry and analytical procedures applied in the review of the financial statements and I (We) are not aware of any material modifications that should be made to that information.

(Firm's signature)

_____ [Report Date]

Review Report--Supplementary Information Not Subjected to Review Procedures

I (We) have reviewed the accompanying balance sheet of _____ [Client Name] as of _____ [Financial Statement Date], and the related statements of income and retained earnings, and cash flows for the _____ [Period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of _____ [Client Name].

A review consists principally of inquiries of Company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

My (Our) review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in Schedules _____ is presented only for supplementary analysis purposes. This information has not been subjected to the inquiry and analytical procedures applied in the review of the financial statements. I (We) compiled this information from information that is the representation of management (the owners), without audit or review and I (we) do not express an opinion or any other form of assurance on this supplementary information.

(Firm's signature)

_____ [Report Date]

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