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Compilation and Review: Definitive Services

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quently, increasing accounting fees? NO. The standard was developed to more closely reflect the level of services being performed and, per se, no additional financial statements nor financial statement disclosures are required by SSARS No. 1.

Departures from the full set of financial information that is collectively called "financial statements" are still permitted *if* disclosed properly in the accountants' report. For instance, if a client desires only an income statement, this new standard does not also require the presentation of a balance sheet, or footnotes. In such a case, the first two paragraphs of the CPA's report would be unchanged and a third paragraph would be added:

Management has elected to omit substantially all of the disclosures, the balance sheet and statement of changes in financial position required by generally accepted accounting principles. If the omitted disclosures were included in the financial information presented, they might influence the user's conclusion about the company's financial position, results of operations, and changes in financial position. Accordingly, the financial statement presented is not designed for those who are not informed about such matters.²

The above modification is only one of a variety of such modifications. Statement No. 1 contains other examples that are too numerous to mention here.

Conclusion

During this time of transition³, SSARS No. 1 will generate much discussion among CPAs, their clients and other financial statement users. The change will also present a special opportunity for a review of existing agreements between clients and CPAs. After exploring the various alternatives and restrictions of the new standard, clients will be able to select the service that more closely matches their needs. The CPA will be able to express a level of assurance that more closely reflects the conclusions reached. While instant understanding is not likely to occur, the changes and clarifications provided by Statement No. 1 should enhance the users' ability to understand the CPA's association with unaudited financial statements and, thereby, the credibility of the CPA. □

FOOTNOTES

¹A nonpublic entity is one which is not required to file financial statements with a regulatory agency in connection with the sale or trading of its securities in a public market.

²Paragraph 21, SSARS, No. 1.

³The effective date of SSARS No. 1 is for periods ending on or after July 1, 1979.

Compilation and Review

Definitive Services

By Carol B. Hardan

Unaudited financial statements comprise a significant segment of the services provided by certified public accountants. For the past half century, the accounting profession has grappled with reporting procedures for both audited and unaudited financial statements. However, because the pronouncements with respect to unaudited financial statements were quite limited, the services performed by the CPAs issuing reports on unaudited financial statements varied greatly.

After careful consideration and in order to establish uniform standards, the American Institute of Certified Public Accountants has now issued "Statement on Standards for Accounting and Review Services No. 1".¹ This Statement provides for two levels of reporting by CPAs on unaudited financial statements. These two levels, compilation and review, as differentiated from an audit, are summarized in this article as a reference for financial statement users so that they may more readily recognize the degree of responsibility the CPA has assumed.

Compilation of Financial Statements

The first level of responsibility relating to unaudited financial statements is a compilation.

A compilation consists of presenting, in the form of financial statements, information that is the representation of management. The accountant does

not express any assurance on the statements presented.

In order to perform a compilation of financial statements, the accountant should:

- Possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates.
- Possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented and the form and content of the financial statements. This knowledge ordinarily is obtained through experience with the entity or through inquiry of entity's personnel.
- Read the compiled financial statements and consider whether they appear to be appropriate in form and free from obvious material errors.

The accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information provided by the entity. However, if the accountant becomes aware that the information supplied by management is incorrect, incomplete or otherwise unsatisfactory, he or she should obtain additional or revised information or withdraw from the compilation engagement entirely.

The requirements relating to financial presentation and footnote disclosures are the same whether for

¹"Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements*", effective for financial statements for periods ending on or after July 1, 1979.

audited, reviewed or compiled financial statements.

The recommended standard accountants' report applicable to compiled financial statements is shown in Exhibit I.

To the Board of Directors
of the Company

The accompanying balance sheet of XYZ Company as of December 31, 19XX and the related statements of income, retained earnings, and changes in financial position for the year then ended *have been compiled by us*.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. 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.

(Signed)

Date

(Italics have been added for this presentation.)

(Departures from generally accepted accounting principles and the effect on the financial statements, if known, should be disclosed in a separate paragraph of the accountants' report.)

Exhibit I

Review of Financial Statements

The second level of responsibility relating to unaudited financial statements is a review.

A review consists of performing inquiry and analytical procedures to provide the accountant with a reasonable basis for expressing limited assurance that no material modifications should be made to the statements in order for them to be in conformity with generally accepted accounting principles.

The objective of the review differs significantly from that of a compilation, where no expression of assurance is contemplated, and from that of an audit, which results in the expression of an opinion on the financial statements taken as a whole.

In order to perform a review of financial statements, the accountant should:

- Possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates.

- Possess a general understanding of the entity's business.

Possessing a general understanding of the entity's business contemplates knowledge of its organization and operating characteristics, including production, distribution, compensation methods, types of products and services, operating locations and material transactions with related parties. It also requires knowledge of the nature of the entity's assets, liabilities, revenues and expenses. This understanding is ordinarily obtained through experience with the entity or its industry and by inquiry of the entity's personnel.

The inquiry and analytical procedures should ordinarily include the following:

- Inquiry concerning the entity's accounting principles and practices and the methods followed in applying them.
- Inquiries concerning the entity's procedures for recording, classifying and summarizing transactions.
- Inquiries concerning actions

taken at shareholders' and Board of Directors' meetings.

- Inquiries of persons having responsibility for financial and accounting matters.
- Comparison of the financial statements with those of a comparable prior period or periods.
- Comparison of the financial statements with anticipated results, if available.
- Study of the relationships of certain interrelated accounts.
- Reading the financial statements to consider whether they appear to conform with generally accepted accounting principles.

The inquiries and analytical procedures to be performed in a review of financial statements are a matter of the accountant's judgment. In reviewing the accounting records the accountant may consider the following:

- The nature and materiality of the items.
- The likelihood of misstatement.
- Knowledge obtained during current and previous engagements.
- The stated qualifications of the

entity's accounting personnel.

- The extent to which a particular item is affected by management's judgment.
- Inadequacies in the entity's underlying financial data.

A review does not contemplate a study and evaluation of internal accounting control, tests of the accounting records or obtaining corroborating evidential material through inspection,

observation or confirmation, since such procedures normally apply only in audits. Therefore, a review does not provide assurance that the accountant will become aware of all significant matters that might be disclosed in an audit.

However, if the accountant becomes aware of information that is inaccurate, incomplete or otherwise unsatisfactory, he or she should perform

additional procedures to achieve limited assurance that there are no material modifications that should be made to the financial statements or withdraw from the review engagement.

The recommended standard accountants' report applicable to reviewed financial statements is shown in Exhibit II.

To the Board of Directors
of the Company

We have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position 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 XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination 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, *we do not express such an opinion.*

Based on our review, *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.

(Signed)

Date

(Italics have been added for this presentation.)

(Departures from generally accepted accounting principles and the effect on the financial statements, if known, should be disclosed in a separate paragraph of the accountants' report.)

Exhibit II

Audits of Financial Statements

The objective of an audit is to provide a reasonable basis for expressing an opinion on the financial statements taken as a whole.

An opinion may be expressed only when the independent auditor has performed an examination in accordance with generally accepted auditing standards.

The opinion may be unqualified:

- The statements present fairly the financial position, results of operations and changes in financial position of the entity, and

conform with generally accepted accounting principles applied on a consistent basis.

The opinion may be qualified:

- An exception is taken to certain items and such exception is disclosed.

The opinion may be adverse:

- The statements do not present fairly the financial position of the entity.

In an audit, the examination must be performed by a person or persons having adequate technical training and proficiency as an auditor. The auditor

must make a proper study and evaluation of internal control and obtain sufficient competent evidential material through inspection, observation, inquiry and confirmation. The auditor must maintain an independence in mental attitude and exercise due professional care in the performance of the examination and in the preparation of the report. All work is to be adequately planned and assistants properly supervised.

The reporting standards may be considered self-evident in the accountants' report.

The accountant's unqualified report with respect to audited financial statements is shown in Exhibit III.

To the Board of Directors
of the Company

We have examined the balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of XYZ Company as of December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

(Signed)

Date

(Italics have been added for this presentation.)

Exhibit III

Table No. 1 provides a quick reference to the levels of responsibility that financial statement users may expect relative to each of the three levels of service.

	Compilation	Review	Audit
No assurance	X		
Limited assurance		X	
Expression of opinion			X
Standard footnote disclosures	X	X	X
Accountant's independence required		X	X

Table No. 1

The American Institute of Certified Public Accountants is continuing to refine the state of the art in the unaudited area. The Institute's Accounting and Review Services Committee has established the following new task forces:

- Task Force on other Accounting Services
- Task Force on Communication With Users When the Accountant Is Not Independent
- Clarification of Independence-Interpretations Task Force
- Task Force on Subsequent Discovery of Facts Existing at the Date of Compilation or Review Report
- Special Reports Task Force

It is interesting to note that the exposure draft on compilation and review drew more comment from the profession than any other pronouncement. Both the profession and the public may be encouraged by the effort now being expended in this area. □



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