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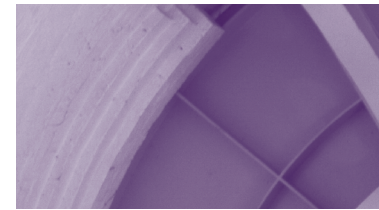
Developments in preparation, compilation, and review engagements, 2015/16

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Developments in Preparation, Compilation, and Review Engagements

2015/16

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Notice to Readers

This 2015/16 edition of the AICPA Alert *Developments in Preparation, Compilation, and Review Engagements* (alert) replaces the AICPA Alert *Developments in Review, Compilation, and Financial Statement Preparation Engagements—2014/15*.

This alert is intended to provide accountants with an update on recent practice issues and professional standards that affect preparation, compilation, and review engagements. This alert also can be used by an entity's internal management to address areas of concern.

This publication is an other preparation, compilation, and review publication, as defined in paragraph .06 of AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. Other preparation, compilation, and review publications have no authoritative status; however, they may help the accountant understand and apply the Statements on Standards for Accounting and Review Services.

In applying the guidance included in an other preparation, compilation, and review publication, the accountant should, using professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement as appropriate. The guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior committee of the AICPA.

Recognition

Reviewers

AICPA Accounting and Review Services Committee

Michael L. Brand, *Chair*

The AICPA gratefully acknowledges those members of the Accounting and Review Services Committee and the AICPA Technical Issues Committee, who helped identify the interest areas for inclusion in this alert.

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Feedback

This alert is published annually. As you encounter issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments you have about the alert also would be appreciated. You may email these comments to A&APublications@aicpa.org.

TABLE OF CONTENTS

	<i>Paragraph</i>
Developments in Preparation, Compilation, and Review Engagements—2015/16	.01-.142
How This Alert Helps You	.01
Economic Developments	.02-.06
The Current Economy	.02-.03
Key Economic Indicators	.04-.06
SSARS No. 21	.07-.44
Preparation of Financial Statements	.12-.24
Peer Review Implications for Engagements to Prepare Financial Statements	.25-.27
Compilation Engagements	.28-.35
Review of Financial Statements	.36-.42
SSARS No. 21 Implementation Resources	.43-.44
Recent AICPA Independence and Ethics Developments	.45-.75
The Revised Code of Professional Conduct	.45
AICPA Conceptual Frameworks	.46-.48
Revisions to the "Nonattest Services" Interpretations	.49-.52
Conflicts of Interest Interpretations Revisions	.53-.61
Breach of an Independence Interpretation	.62-.75
Current Practice Issues	.76-.83
Engagement Letters	.76-.79
Preparation of Financial Statements for an Attest Client	.80-.82
Lessons Learned From Professional Liability Claims in Review and Compilation Services	.83
Peer Reviews of Compilation and Review Engagements	.84-.100
Matters for Consideration	.84-.86
Common Peer Review Findings—Review Engagements	.87-.95
Common Peer Review Findings—Compilation Engagements	.96-.100
Recent Activities of FASB's Private Company Council	.101-.115
Intangible Assets in a Business Combination	.102-.105
Accounting for Goodwill	.106-.108
Simplified Hedge Accounting	.109-.111
Variable Interest Entities	.112-.115
On the Horizon	.116-.121
ASU No. 2014-15	.118-.119
Proposed SSARS on Preparation and Compilation of Prospective Financial Information and Proposed SSARS on Compilation of Pro Forma Financial Information	.120-.121
Resource Central	.122-.141
Publications	.123
The Engagement Letter: Best Practices and Examples	.124

Developments in Preparation, Compilation, and Review
Engagements—2015/16—continued

FRF for SMEs Toolkits .....	.125-.126
Decision Tool for Adopting FRF for SMEs .....	.127
Continuing Professional Education .....	.128-.131
Webcasts .....	.132
Member Service Center .....	.133
Hotlines .....	.134-.135
The AICPA Center for Plain English Accounting .....	.136
AICPA Online Professional Library: Accounting and Auditing Literature .....	.137
AICPA Practice Aid Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements .....	.138
Financial Reporting Center of AICPA.org .....	.139-.141
Appendix A—Additional Internet Resources .....	.142

How This Alert Helps You

.01 This Alert (alert) helps you plan and perform your preparation, compilation, and review engagements and can also be used by an entity's internal management to plan and prepare in advance of the engagement. This alert discusses recent Statements on Standards for Accounting and Review Services (SSARSs) developments, addresses current and emerging practice issues, and provides valuable information regarding accounting and reporting developments. You should refer to the full text of pronouncements addressing preparation, compilation, and review engagements, as well as the full text of any rules or publications discussed in this alert. For developing issues that may have a significant impact on preparation, compilation, and review engagements in the near future, the "On the Horizon" section provides information on these topics, including guidance that either has been issued but is not yet effective or is in a developmental stage.

Economic Developments

The Current Economy

.02 In performing a review engagement, accountants are required to possess an understanding of the industry in which the entity operates.¹ This understanding may be affected by general economic conditions. For example, interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions, are likely to have an effect on an entity's industry, its business, and, ultimately, its financial statements. Considering the effects of these external forces may help the accountant better understand the client's industry and business. These considerations may also help the accountant determine the specific nature, timing, and extent of review procedures to be performed.

.03 During 2014 and into 2015, the U.S. economy continued to recover. The S&P 500 and the Dow Jones Industrial Average both reached all-time highs during 2015. The Chicago Board Options Exchange Volatility Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock option prices and is considered by many to indicate investor sentiment, market volatility, and the best gauge of fear in the market. The VIX continued to show a steady decline during the end of 2014 and into 2015. During that time, prices have ranged from 31.06–10.88. The volatility indicates there is still some uncertainty; however, the continued downward trend shows that investors believe the economy and market are improving.

Key Economic Indicators

.04 The following key economic indicators reaffirm the recovery of the economy during the end of 2014 and into 2015: GDP, unemployment, and the federal fund rate. The GDP measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as it slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 2.3 percent in the second quarter of 2015, based on the advance estimate (second estimate), and increased at an annual rate of

¹ Paragraph .14 of AR-C section 90, *Review of Financial Statements* (AICPA, *Professional Standards*).

0.6 percent in the first quarter of 2015. The increase in real GDP in the second quarter has been attributed to positive contributions from personal consumption expenditures, state and local government spending, and residential fixed investments, among other factors.

.05 From August 2014 to August 2015, the unemployment rate fluctuated between 6.1 percent and 5.3 percent. A rate of 5.3 percent represents approximately 8.3 million people who are unemployed. Based on the Bureau of Labor Statistics (BLS), from August 2014 to August 2015, the average employment growth was 246,000 per month. During that same time period, the number of long-term unemployed (those jobless for 27 weeks or more) had decreased by 59,000, indicating more growth in the economy. Based on the BLS, the number of people employed part-time for economic reasons decreased to 6.3 million during the second quarter of 2015. Together, these statistics illustrate the continued improvement in the economy.

.06 The Board of Governors of the Federal Reserve System (Federal Reserve) decreased the target for the federal funds rate more than 5.0 percentage points, from its high of 5.25 percent prior to the financial crisis, to less than 0.25 percent, where it remained through August 2015. The Federal Reserve indicates that the target range for federal funds rates of 0–0.25 percent is appropriate for as long as the unemployment rate stays above 6.5 percent; inflation over the next two years is projected to be less than 0.5 percent above the 2.0-percent longer-run goal; and longer-term inflation projections continue to be low.

Author's Note

For information on legislative and regulatory developments, readers may find it helpful to refer to the AICPA's Audit Risk Alert *General Accounting and Auditing Developments—2015/16* available at www.cpa2biz.com. Although the audience for that publication is primarily auditors, the content on legislative and regulatory developments has broad application so that practitioners performing engagements in accordance with SSARSs may find it helpful.

SSARS No. 21

.07 SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification* (AICPA, *Professional Standards*), was issued in October 2014. Along with clarifying the SSARSs literature, SSARS No. 21 significantly affects the literature for accountants in public practice who prepare financial statements.

.08 This standard is effective for preparation, compilation, and review engagements of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

.09 SSARS No. 21 supersedes all extant AR sections in AICPA *Professional Standards*, with the exception of AR section 120, *Compilation of Pro Forma Financial Information* (AICPA, *Professional Standards*). AR section 120 will be superseded by an additional clarity SSARS at a future date.

.10 SSARS No. 21 is structured as follows:

- Section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. Provides general principles for SSARSs engagements.
- Section 70, *Preparation of Financial Statements*. *Preparation of Financial Statements* is a new section issued as part of SSARS No. 21. This new section provides requirements and guidance to an accountant who is engaged to prepare financial statements for an entity but not engaged to perform a compilation, review, or audit with respect to those financial statements.
- Section 80, *Compilation Engagements*. Provides requirements and guidance to an accountant when engaged to perform a compilation engagement on financial statements.
- Section 90, *Review of Financial Statements*. Provides requirements and guidance to an accountant when engaged to review financial statements.

.11 The sections of SSARS No. 21 are codified in AICPA *Professional Standards* as AR-C sections and use the same section numbers found in SSARS No. 21. The pre-clarified AR sections will remain in *Professional Standards* until the clarified standards are fully effective.

Preparation of Financial Statements

.12 AR-C section 70 applies when an accountant in public practice is engaged to prepare financial statements but is not engaged to perform an audit, review, or a compilation on those financial statements. The section does not apply in situations when the accountant is not in public practice.

.13 AR-C section 70 does not apply when the accountant has been engaged to merely assist in preparing the financial statements or when the accountant prepares financial statements as a by-product of another engagement (for example, if the accountant is engaged to prepare an entity's tax return). In order to facilitate the preparation of the tax return, the accountant often prepares financial statements. If the accountant decides to include a copy of the financial statements in the tax-deliverable package to the client, AR-C section 70 does not apply because the accountant was not engaged to prepare financial statements. However, it is very important that the accountant and the client have an understanding, in writing, at the beginning of the engagement about what the expectations are. There may be instances in which the accountant will have to apply professional judgment.

.14 Because the preparation of financial statements is a nonattest service, the accountant is not required to consider whether he or she is independent of the client. Independence only becomes relevant if the accountant is engaged to perform a compilation, review, or audit of the financial statements that he or she prepared.

.15 An important aspect of SSARS No. 21 is the requirement to obtain an engagement letter or other suitable form of written agreement, signed by both the accountant or the accountant's firm and management or those charged with governance, as appropriate. The requirement to obtain a signed engagement letter or other suitable form of written agreement is applicable to all preparation, compilation, and review services performed in accordance with SSARSs.

.16 The accountant can prepare financial statements

- that omit all or substantially all disclosures required by the applicable financial statements.
- in accordance with a special purpose framework, such as the cash- or tax-basis of accounting.
- that contain a known departure from the applicable financial reporting framework.

.17 A report is not required even when financial statements are expected to be used by or presented to a third party. Instead, the accountant is required to ensure that a statement is included on each page of the financial statements, including the related notes indicating, at a minimum, "that no assurance is provided" on the financial statements. Although not required, the accountant is not precluded from including the accountant's name or the accountant's firm name in the statement, nor is the accountant precluded from including positive language in the statement. Examples of language that can be used in the statement are as follows:

- No assurance is provided on these financial statements.
- These financial statements have not been subjected to an audit, review, or compilation engagement, and no assurance is provided on them.
- No assurance is provided by ABC CPAs on these financial statements.
- ABC CPAs did not perform an audit, review, or compilation engagement on these financial statements, and no assurance is provided on them.

.18 The statement on each page of the financial statements, including the related notes, ensures that users of the financial statements are able to readily identify that the accountant is providing no assurance on the financial statements.

.19 If management refuses to or cannot include the statement (which should be rare given that previous standards required that the financial statements include a statement referring the reader to the accountant's compilation report), the accountant can either issue a disclaimer that makes clear that no assurance is provided on the financial statements or perform a separate service in which a report is issued, such as a compilation, review, or audit. The accountant also may choose to withdraw from the engagement.

.20 The preparation service resembles a traditional "management's use only" compilation—with the removal of the limitation on distribution.

.21 When the accountant is engaged to prepare financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant is required to disclose such omission in the financial statements. This can be easily accomplished in the financial statement titles, as follows:

ABC Company
Balance Sheet
Substantially All Disclosures Required by GAAP Are Omitted
December 31, 20X2

.22 If the accountant is engaged to prepare financial statements that contain a known departure from the applicable financial reporting framework, the accountant is required to disclose the departure in the financial statements. This can be easily accomplished in a note to the financial statements, for example:

Note 1—Summary of Significant Accounting Policies

Basis of Accounting

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, except for the valuation of land. Accounting principles generally accepted in the United States of America require that land be recorded at cost. However, the Company has recorded its land at appraised value. If accounting principles generally accepted in the United States of America had been followed, the land and stockholder's equity would have decreased by \$500,000.

.23 The accountant can disclose the omission of the statement of cash flows in a similar manner:

Note 1—Summary of Significant Accounting Policies

Basis of Accounting

The Company's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America, except a statement of cash flows has not been presented. Accounting principles generally accepted in the United States of America require that such a statement be presented when financial statements purport to present financial position and results of operations.

.24 When preparing financial statements in accordance with a special purpose framework, such as the cash-, tax-, modified cash-, regulatory-, or contractual-basis of accounting, the accountant is required to include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. Often, that disclosure is made next to or under the title of the financial statements (for example, "Statements of Assets and Liabilities—Modified Cash-Basis").

Peer Review Implications for Engagements to Prepare Financial Statements

.25 Although most state boards of accountancy require their licensees to participate in peer review, which may also be called *compliance assurance*, in order to continue practicing in that state, there may be some diversity among states about whether the performance of a preparation engagement would require enrollment in a peer review program. Practitioners should carefully consult the requirements for each state in which they operate.

.26 In January 2015, the AICPA Peer Review Board (board) approved guidance that would not require firms that only perform engagements to prepare financial statements in accordance with AR-C section 70 to be, or remain enrolled in, an approved peer review program. However, if that same firm remains enrolled or elects to enroll, then it would be required to undergo a peer review. For a system review, engagements to prepare financial statements would not be required to be selected. For engagement reviews, engagements to prepare financial statements would be selected in certain circumstances.

The board wants to facilitate AICPA members' compliance, as well as others' compliance, with the state board of accountancy licensing requirements and mitigate any mobility challenges that may arise if these engagements were not subject to peer review in some capacity.

.27 The peer review guidance related to engagements to prepare financial statements was effective for peer reviews commencing on or after February 1, 2015.

Compilation Engagements

.28 AR-C section 80 applies when the accountant is engaged to perform a compilation engagement. Other than the change regarding when the literature applies, AR-C section 80 is largely unchanged from the pre-SSARS No. 21 literature. The primary difference between AR-C section 80 and the pre-SSARS No. 21 literature is the reporting requirements.

.29 Because AR-C section 80 applies when the accountant is engaged, the accountant is always required to issue a compilation report. However, to differentiate the non-assurance compilation report from assurance (review and audit) reports, the compilation report is now streamlined so that the standard report is just one paragraph with no headings. AR-C section 80 retains the requirement that the accountant modify the accountant's compilation report whenever the accountant's independence is impaired.

.30 SSARS No. 21 has eliminated the management use only compilation. The management use only compilation was created when SSARS No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements*, was issued to allow accountants to prepare financial statements and avail themselves of a non-reporting exception as long as the financial statements were not expected to be used by a third party. Preparation engagements performed in accordance with AR-C section 70 provide accountants with the ability to perform essentially the same service without being concerned if the financial statements are used by a third party.

.31 As with AR-C sections 70 (preparation) and 90 (reviews), in a compilation engagement performed in accordance with AR-C section 80, the accountant is required to obtain an engagement letter or other suitable form of written agreement, signed by both the accountant or the accountant's firm and management or those charged with governance, as appropriate.

.32 The accountant may perform a compilation when the financial statements omit substantially all disclosures required by the applicable financial reporting framework.

.33 The following is an illustration of a standard accountant's compilation report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America:

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1 and the related statements of income, changes in stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with

Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

.34 Additional paragraphs are required when

- the accountant's independence is impaired;
- the financial statements are prepared in accordance with a special purpose framework, such as the cash- or tax-basis of accounting;
- the financial statements omit substantially all disclosures required by the applicable financial reporting framework;
- the financial statements contain known departures from the applicable financial reporting framework; and
- supplementary information accompanies the financial statements and the accountant's report thereon.

.35 Additional illustrative accountant's compilation reports are included as an exhibit to AR-C section 80 and in the AICPA Guide *Preparation, Compilation, and Review Engagements*.

Review of Financial Statements

.36 The review literature was substantially updated when SSARS No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*), was issued in December 2009. SSARS No. 21 is primarily a clarity redraft of SSARS No. 19 with respect to review engagements. The most significant changes to extant AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), include changes to the accountant's review report.

Scope

.37 AR-C section 90 makes clear that the section may be applied to historical financial information other than historical financial statements, such as the following:

- Specified elements, accounts, or items of a financial statement
- Supplementary information
- Required supplementary information
- Financial information included in a tax return

Engagement Letter

.38 As with AR-C sections 70 (preparation) and 80 (compilations), in a review engagement performed in accordance with AR-C section 90, the accountant is required to obtain an engagement letter or other suitable form of written agreement, signed by both the accountant or the accountant's firm and management or those charged with governance, as appropriate.

Reporting on the Financial Statements

.39 AR-C section 90 requires the use of headings throughout the accountant's review report to clearly distinguish each section of the report.

.40 Additionally, AR-C section 90 requires that the accountant's review report name the city and state of the issuing office. The application material makes clear that the city and state where the accountant practices may be indicated on letterhead that contains the issuing office's city and state.

Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant's Review Report

.41 AR-C section 90 requires the accountant to include an emphasis-of-matter or other-matter paragraph in the accountant's review report relating to the following matters:

- Financial statements prepared in accordance with a special purpose framework (pursuant to paragraphs .43–.44 of AR-C section 90)
- A changed reference to a departure from the applicable financial reporting framework when reporting on comparative financial statements (pursuant to paragraph .49 of AR-C section 90)
- Reporting on comparative financial statements when the prior period is audited (pursuant to paragraph .50 of AR-C section 90)
- Reporting a known departure from the applicable financial reporting framework that is material to the financial statements (pursuant to paragraph .57 of AR-C section 90)
- Reporting when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date, and the accountant's review report on the revised financial statements differs from the accountant's review report on the original financial statements (pursuant to paragraph .75c of AR-C section 90)
- Supplementary information that accompanies reviewed financial statements and the accountant's review report thereon (pursuant to paragraph .80 of AR-C section 90)
- Required supplementary information (pursuant to paragraph .83 of AR-C section 90)

.42 Illustrative accountant's review reports are included as an exhibit to AR-C section 90 and in the AICPA Guide *Preparation, Compilation, and Review Engagements*.

SSARS No. 21 Implementation Resources

.43 The AICPA offers several resources to assist practitioners in implementing SSARS No. 21. The 2015 AICPA Guide *Preparation, Compilation, and Review Engagements* includes more extensive details relating to SSARS No. 21, implementation guidance, several illustrative engagement letters, and several new illustrative review and compilations reports. A new continuing education course is also available that specifically addresses the new preparation standard and guidance on how to perform an engagement to prepare financial statements. Additionally, the AICPA is offering an online version of a new continuing education curriculum titled, "Preparation, Compilation, and Review Engagement Staff Essentials." This curriculum covers all engagements governed by SSARSs and guides users on how to plan, perform, and report on SSARSs engagements. This broad-ranging curriculum includes case studies

and practical examples to provide users with real-life scenarios and the best practices they can employ to approach them.

.44 Further, check the dedicated ARSC Clarity Project page at www.aicpa.org for frequent updates.

Recent AICPA Independence and Ethics Developments

The Revised Code of Professional Conduct

.45 A revised AICPA Code of Professional Conduct (the code) became effective on December 15, 2014. In an effort to make the code easier to use, it is available on a new and dynamic online platform accessible at <http://pub.aicpa.org/codeofconduct>. It is broken down into different parts by line of practice, is intuitively arranged by topic, and, where necessary, subtopic and section, and incorporates the conceptual framework approach, all while retaining the substance of the existing AICPA ethics standards. The new format allows for quick and easy navigation and also identifies when nonauthoritative content is available on a particular topic.

AICPA Conceptual Frameworks

.46 Aside from the format change, the most significant change is the incorporation of two conceptual frameworks, one for members in public practice and one for members in business. The conceptual framework approach, also known as the "threats and safeguards" approach, is a way of identifying, evaluating, and addressing threats that may exist and safeguards that may be applied to eliminate or reduce those threats to an acceptable level. The conceptual framework is used for areas where the code lacks guidance. This new section broadens the reach of the code by allowing members to reach conclusions even if specific guidance is not written in the code. In order to allow members additional time to implement the two conceptual frameworks, they will not be effective until December 15, 2015, and early implementation is encouraged.

AICPA Conceptual Frameworks Toolkits

.47 The AICPA is developing conceptual framework toolkits for all three of the conceptual frameworks. The toolkits will assist members in understanding and applying the conceptual framework concepts to their specific situations. Specifically, the toolkits include the following:

- Steps of the conceptual framework to provide members with detailed guidance on what to do when applying the conceptual framework approach.
- A flowchart that serves as a visual aid for breaking down the steps of the conceptual framework approach.
- A worksheet to aid members with applying the steps of the conceptual framework. An example of how to use this worksheet is included in the toolkit.
- Examples of relationships or circumstances that are not addressed in the AICPA code and how the conceptual framework may be applied in such situations.

.48 They are expected to be available in 2015. Check the Ethics Tools and Aids page for updates at www.aicpa.org.

Revisions to the "Nonattest Services" Interpretations

Cumulative Effect on Independence When Providing Nonattest Services

.49 A new interpretation, the "Cumulative Effect on Independence When Providing Multiple Nonattest Services" interpretation (AICPA, *Professional Standards*, ET. sec. 1.295.020), which was effective December 15, 2014, now requires a member in public practice to consider the cumulative effect on independence that arises from a member or member's firm performing multiple permitted nonattest services or engagements.

.50 The Professional Ethics Executive Committee (PEEC) has determined that performing multiple nonattest services can increase the significance of the self-review and management participation threats, as well as other threats to independence. Under the new requirements, it is not sufficient for a member to consider only the threats to independence at the time an engagement to perform a nonattest service begins. Rather, a member is now required to evaluate whether the performance of multiple nonattest services in the aggregate creates a significant threat to the member's independence that cannot be reduced to an acceptable level by the application of the safeguards outlined in the interpretation's general requirements section. In cases in which threats are not at an acceptable level, the interpretation requires the member to apply additional safeguards to eliminate the threats or reduce them to an acceptable level. If safeguards cannot eliminate or reduce threats to an acceptable level, to maintain independence, the member should not perform the additional nonattest services.

Certain Services Performed in Connection With an Attest Engagement

.51 The AICPA's Professional Ethics Division has noted for several years that there has been confusion among members in public practice concerning services typically performed in conjunction with an attest engagement, such as preparation of financial statements, cash-to-accrual conversions, reconciliations, and similar activities. PEEC clarified these situations and added guidance to the "Scope and Applicability of Nonattest Services" interpretation (AICPA, *Professional Standards*, ET sec. 1.295.010) stating that activities such as financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement and, therefore, constitute a nonattest service. Such activities would not impair independence provided the requirements of this interpretation are met.

.52 The requirement to treat these services, as well as any other services of a similar nature, as nonattest services was effective for engagements covering periods beginning on or after December 15, 2014.

Conflicts of Interest Interpretations Revisions

.53 PEEC adopted revised versions of the "Conflicts of Interest for Members in Public Practice" interpretation (AICPA, *Professional Standards*, ET. sec. 1.110.010) and the "Conflicts of Interest for Members in Business" interpretation (AICPA, *Professional Standards*, ET. sec. 2.110.010). The revisions discussed in the following section were effective as of September 30, 2014.

.54 The conflict of interest interpretations for both members in public practice and members in business were revised in an effort to clarify the

applicability of the interpretations and the steps required when a conflict of interest is identified.

.55 A member in public practice or his or her firm or a member in business may be faced with a conflict of interest when performing or undertaking a professional service. When determining whether a professional service, relationship, or matter would result in a conflict of interest, a member should use professional judgment, taking into account whether a reasonable and informed third party who is aware of the relevant information would conclude that a conflict of interest exists.

Identification of a Conflict of Interest

.56 When identifying whether a conflict of interest exists or may be created, a member should take reasonable steps to determine

- the nature of the relevant interests and relationships between the parties involved and
- the nature of the service and its implication for relevant parties.

.57 Members should remain alert to changes in relevant interests and relationships and services provided during the course of the engagement for the purpose of identifying circumstances that might create a conflict of interest.

Evaluation of a Conflict of Interest

.58 When an actual conflict of interest has been identified, the member should evaluate the significance of the threat created by the conflict of interest to determine if the threat is at an acceptable level. In evaluating the significance of an identified threat, members should consider both of the following:

- The significance of relevant interests or relationships.
- The significance of the threats created by performing the professional service or services. In general, the more direct the connection between the professional service and the matter on which the parties' interests are in conflict, the more significant the threat to compliance with the rule will be.

.59 If the member concludes that the threat is not at an acceptable level, the member should apply safeguards to eliminate the threat or reduce it to an acceptable level.

.60 In cases when an identified threat may be so significant that no safeguards will eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the member should (a) decline to perform or discontinue the professional services that would result in the conflict of interest or (b) terminate the relevant relationships or dispose of the relevant interests to eliminate the threat or reduce it to an acceptable level.

.61 The member is encouraged to document the nature of the circumstances that gives rise to the conflict of interest, the safeguards applied to eliminate or reduce the threats to an acceptable level, and the consent obtained.

Breach of an Independence Interpretation

.62 In March 2015, PEEC adopted a new interpretation, "Breach of an Independence Interpretation" (AICPA, *Professional Standards*, ET. sec 1.298.010). This interpretation will be effective on March 31, 2016. Early implementation is permitted.

.63 The "Breach of an Independence Interpretation" was created primarily due to international convergence with the International Ethics Standards Board for Accountants. PEEC revised a previously published, nonauthoritative document and used that as a basis for drafting this interpretation.

.64 This interpretation provides guidance to assist members in evaluating and addressing the consequences of a breach of an independence interpretation and the effect on the attest engagement team's integrity, objectivity, and professional skepticism so the member or member's firm can determine if the consequences of a breach can be satisfactorily addressed.

Required Policies and Procedures Established by the Firm

.65 In order for this interpretation to address the consequences of an independence breach, the firm must be compliant with QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), which requires the member's firm to have established policies and procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence when required. These policies and procedures should be designed to provide the firm with reasonable assurance that it will be notified of breaches of independence requirements and enable it to take appropriate actions to resolve such situations.

Breaches Resulting in Significant Threats

.66 In situations in which the attest engagement team's integrity, objectivity, and professional skepticism are compromised, the provisions of this interpretation could not address the consequences of the breach because no actions could be taken to satisfactorily address the consequences of the breach.

.67 In situations in which the lead attest engagement partner or an individual in a position to influence the attest engagement either (1) committed the breach or (2) knows of a breach and fails to ensure the breach is promptly communicated to or known by an appropriate individual within the firm as described in this interpretation, there is a rebuttable presumption that the provisions of this interpretation would not be able to address the breach because the threats to the attest engagement team's integrity, objectivity, and professional skepticism and the threats to the appearance of independence would be considered so significant that no actions could be taken to satisfactorily address the consequences of the breach.

Identifying and Communicating a Breach

.68 When a breach is identified, the responsible individual should report the breach to those who need to take appropriate action. The responsible individual should be satisfied that the interest or relationship that caused the breach has been terminated, suspended, or eliminated and address the consequences of the breach.

Evaluating the Significance of the Breach

.69 The responsible individual should evaluate the significance of the breach and its effect on the attest engagement team's integrity, objectivity, and professional skepticism and the ability to issue an attest report.

Addressing the Consequences of a Breach

.70 Depending upon the significance of the breach, it may be necessary to terminate the attest engagement, or it may be possible to take action that satisfactorily addresses the consequences of the breach. Certain breaches described in this interpretation cannot be addressed by the provisions of this interpretation. For all other breaches, the responsible individual should determine whether satisfactory action can be taken and is appropriate in the circumstances.

Communicating With Those Charged With Governance

.71 If the responsible individual determines that action cannot be taken to satisfactorily address the consequences of the breach, the responsible individual should inform those charged with governance as soon as practicable and take the steps necessary to terminate the attest engagement in compliance with any applicable legal or regulatory requirements relevant to terminating the attest engagement. When termination is not permitted by law or regulation, the responsible individual should comply with any reporting or disclosure requirements.

.72 If the responsible individual determines that action can be taken to satisfactorily address the consequences of the breach, the responsible individual should discuss the breach and the action taken, or proposed to be taken, with those charged with governance as soon as practicable, unless those charged with governance have specified an alternative timing for reporting less significant breaches.

.73 Communication with those charged with governance should be in writing and include a description of the firm's policies and procedures relevant to the breach designed to provide with reasonable assurance that independence is maintained and any steps that the firm has taken, or proposes to take, to reduce or avoid the risk of further breaches occurring.

Breaches Relating to Previously Issued Reports

.74 If the breach occurred prior to the issuance of the previous attest report, the responsible individual should comply with this section in evaluating the significance of the breach and its effect on the attest engagement team's objectivity, integrity, and professional skepticism, and its ability to issue an attest report in the current period. The responsible individual should also consider the effect of the breach, if any, on the attest engagement team's integrity, objectivity, and professional skepticism in relation to any previously issued attest reports, and the possibility of withdrawing such attest reports in accordance with professional standards, and discuss the matter with those charged with governance.

Documentation

.75 The responsible individual should document the breach, the action taken, key decisions made, and all the matters discussed with those charged

with governance and any discussions with a professional body, relevant regulator, or oversight authority. When the firm continues with the attest engagement, the matters to be documented should also include the conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the attest engagement team have not been compromised and the rationale for why the action taken satisfactorily addressed the consequences of the breach such that the firm could issue an attest report.

Current Practice Issues

Engagement Letters

.76 Paragraph .11 of section 90, paragraph .10 of section 80, and paragraph .10 of section 70 of SSARS No. 21 require that the accountant agree upon the terms of the engagement with management and document the agreed-upon terms of the engagement in an engagement letter or other suitable form of written agreement. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed. A formal contract is another suitable form of written agreement. A verbal understanding with management is insufficient.

.77 It is essential that both management and the accountant have a clear understanding of the services the accountant has been engaged to perform. Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or perform certain functions that are management's responsibility.

.78 This is of particular importance regarding the preparation of financial statements. The accountant should ensure that management fully understands what the preparation service entails and that no report will accompany the financial statements. If the accountant was previously engaged to perform a compilation of financial statements and the client elects to engage the accountant to prepare the financial statements and not perform a compilation engagement in accordance with AR-C section 80, it would be in the best interest of the client and the accountant to discuss the differences between the two services prior to the commencement of the engagement.

.79 If the accountant or the accountant's firm does not elect to implement SSARS No. 21 prior to December 15, 2015, and the accountant or the accountant's firm is obtaining an annual engagement letter that covers engagements performed in accordance with both SSARS No. 19 and SSARS No. 21, the engagement letter is required to include the required elements from each standard. The Audit and Attest Standards team has prepared a table comparing the required elements of the engagement letter for compilation and review engagements under SSARS No. 19 and SSARS No. 21. This table can be viewed at www.aicpa.org.

Preparation of Financial Statements for an Attest Client

.80 For many years, accountants would prepare financial statements as part of attest engagements (audits, reviews, and compilations).

.81 However, as noted in paragraph .51, PEEC has concluded that services such as preparation of financial statements, cash-to-accrual conversions, reconciliations, and similar activities are outside the scope of the attest (audit, review, or compilation) engagement and, instead, represent a separate engagement that would be subject to the general requirements of the "Nonattest Services" interpretations.

.82 This may not have a tremendous effect on the way many practitioners perform their audit, review, or compilation engagements if such practitioners are able to maintain their independence. However, practitioners who are unable to meet the general requirements of the "Nonattest Services" interpretation with respect to the financial statement preparation will not be independent and will be precluded from performing an audit or review with respect to those financial statements. Although the accountant would not be precluded from performing a compilation engagement, the accountant would have to disclose a lack of independence in the accountant's compilation report.

Lessons Learned From Professional Liability Claims in Review and Compilation Services

.83 The following section was taken from "Lessons Learned from Professional Liability Claims in Review and Compilation Services," by Sarah Beckett Ference, CPA and Stanley D. Sterna, JD. Ms. Ference is risk control director at CNA, and Mr. Sterna is a claim director at CNA. The AICPA thanks them for their assistance and providing guidance to our members.²

At some point, most businesses will need to prepare and provide financial statements to those charged with governance and management of the business and even to third parties, such as lenders, potential investors, surety or bonding companies, or suppliers. In many cases, it is specified or required that the financial statements be subjected to an audit, review, or compilation by an outside CPA firm. Whether it is the client wanting a lower fee or the CPA firm wishing to perform a seemingly less risky service, a review or compilation service is often selected over an audit.

However, review and compilation services are not without professional liability risk. According to claim data from CNA, the endorsed

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underwriter of the AICPA Professional Liability Insurance Program, the leading cause of loss for claims asserted in 2014 against CPA firms providing compilation or review services was a failure to detect a theft or a fraud. The second leading cause of loss was a failure to perform appropriate testing. Although there is no assurance obtained or provided in a compilation and a lesser level of assurance obtained in a review when compared to an audit, the causes of loss in review and compilation claims are similar to that of audit claims.

To illustrate how these claims can arise, consider the following scenarios based on actual claim experience.

- A CPA firm performed a compilation for a physician. The physician's administrative assistant embezzled over \$500,000 from the physician who alleged the CPA firm should have detected the defalcation. The lack of an engagement letter and expansion of the scope of services over time, which included an investigation of the embezzler's work activities, made it difficult to defend the claim.
- A CPA firm performed a review for a construction company, which subsequently filed for bankruptcy. A third party surety paid over \$1 million to settle claims against the construction company for failing to complete projects. The surety then brought a claim against the CPA firm asserting reliance on the review report when issuing the bonds. While arguments were made regarding the surety's failure to conduct adequate due diligence, expert review of the CPA firm's workpapers highlighted concerns about the firm's lack of review procedures over an uncollected receivable, which accounted for a significant portion of the construction company's assets.
- A CPA firm performed a compilation for an auto dealership. It was discovered that non-existent vehicles had been recorded on the balance sheet of the dealership as a result of a fictitious VIN fraud scheme. The dealership asserted that \$4.5 million was paid to a bank as interest on the non-existent vehicles and alleged the CPA firm should have detected the fraud. The CPA firm stated that journal entries were made at the direction of the dealership's general manager. However, the CPA firm also acknowledged that the financial statements seemed incorrect. The lack of an engagement letter defining the limitations of a compilation engagement, workpaper disarray, and the firm's failure to follow-up on significant red flags that may have uncovered the possible fraud hampered the defense of the claim.

Key Deficiencies

Common themes arise when professional liability claims are asserted related to compilation and review services. These themes directly relate to violations of the standard of care and performance standards set forth by SSARS No. 21, specifically:

- The failure to agree the terms of the engagement with management or those charged with governance and the failure to document that agreement in a signed engagement letter or other suitable form of written agreement (AICPA, *Professional Standards*, AR-C sec. 80 par. .10–.11 and AR-C sec. 90 par. .11–.12);
- The failure to follow up on information that may be incorrect, incomplete or otherwise unsatisfactory (AICPA, *Professional Standards*, AR-C sec. 80 par. .14 and AR-C sec. 90 par. .29) or the failure to perform additional procedures when unexpected or inconsistent results are noted (AICPA, *Professional Standards*, AR-C sec. 90 par. .21); and
- The failure to adequately document procedures performed (AICPA, *Professional Standards*, AR-C sec. 80 par. .38 and AR-C sec. 90 par. .91–.92).

Risk Management Recommendations

To help address these common deficiencies, consider the following risk management recommendations:

- *Engagement Letters*—Issue an **annual** engagement letter in accordance with SSARs, signed by both the CPA firm and the client, for all services to be rendered, including any and all nonattest services. An annual engagement letter was not present in nearly 30 percent of all claims related to review and compilation services made in 2014 against CPA firms in the AICPA Professional Liability Insurance Program. A strong engagement letter includes key components, such as:
 - The scope of services to be rendered;
 - The limitations of those services, including the lack of responsibility by the CPA firm to detect theft or fraud and the fact that limited or no assurance is being provided; and
 - The responsibilities of the CPA firm and management.

Illustrative engagement letters are included as exhibits to AR-C sections 70, 80, and 90 for preparation, review, and compilation engagements, respectively, and the AICPA Guide *Preparation, Compilation, and Review Engagements*.

- *Additional Procedures*—Follow up on red flags or items that appear incorrect, inconsistent, or otherwise unsatisfactory. This is a requirement of the professional standards, even in a compilation. If something does not appear right, follow up. Perform additional inquiries or procedures when considered necessary. Performing additional procedures in these situations does not increase the level of service or hold the firm to a higher standard and can be invaluable in defending a professional liability claim. Be

sure to document the additional inquiries or procedures performed as well as management's responses or results in the workpapers.

- *Internal Control*—While obtaining an understanding of the client's internal control is not required in a preparation, compilation, or review engagement, the CPA firm may nonetheless observe internal control weaknesses which may increase the client's risk of theft or fraud. In such instances, it is recommended that the firm communicate the weaknesses to management in writing annually unless the deficiency is remediated. If the communication is made orally, it is recommended that the CPA firm follow up the discussion with a brief communication, such as an email, confirming the details of the client discussion. Holding and documenting these discussions with the client may assist in the defense of a professional liability claim related to failure to detect theft or fraud.
- *Documentation of Procedures*—Clearly document work performed to support delivery of services as described in the engagement letter. Prepare the engagement workpapers so that they clearly indicate how the CPA firm complied with the professional standards and support the report issued, if applicable.
- *Invoice Documentation*—While firms are generally cognizant of the need to maintain appropriate workpapers, many overlook the wording included on client invoices. Billing narratives should likewise support the work performed. Consider attaching a copy of the engagement letter to client invoices to clearly demonstrate that the invoice was only for the services outlined in the engagement letter.
- *Scope*—Ensure the scope of work to be performed is clear and understood by all team members and the client. If additional services are considered necessary, document the revised scope and fee impact in a communication with the client. Depending upon the extent of the revision, the client communication could be a simple email, an engagement letter amendment, or a new engagement letter.
- *Level of Service*—Ensure the client understands the different levels of service. Clients may not be sufficiently informed about the differences between an audit, review, or compilation. The result may be that a client inappropriately believes that audit procedures will be performed in a financial statement review or that a CPA performing a compilation service will provide assurance that the financial statements are correct. These misunderstandings are the basis of "expectation gap syndrome," which can lead to inappropriate presumptions about the CPA firm's responsibility to detect financial statement errors, fraud, and theft.

Application to Financial Statement Preparation Services

The introduction of financial statement preparation services provides CPA firms with an opportunity to manage their professional liability risk if the CPA firm understands and follows the professional standards governing this service. Obtaining an engagement letter signed by the client and CPA firm, ensuring the client understands the level of service provided, and including a statement on each page of the financial statements and notes to the financial statements that no assurance is provided are all required procedures and assist in managing professional liability risk related to this service.³

Peer Reviews of Compilation and Review Engagements**Matters for Consideration**

.84 In performing peer review engagements, peer reviewers use matter for further consideration (MFC) forms to document issues identified based on the review of individual engagements or the firm's system of quality control, or both. A matter is noted as a result of evaluating whether an engagement submitted for review was performed or reported on in conformity with applicable professional standards, or both. The evaluation includes reading the financial statements or information and the related accountant's reports and assessing the adequacy of procedures performed, including related documentation. Matters included on these forms may stay as matters or be elevated to findings or deficiencies.

.85 Depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding, deficiency, or significant deficiency.

.86 The AICPA Peer Review Program collects data during peer reviews to learn about trouble spots and is developing resources within the AICPA that will allow firms to have a more focused remedy for their findings. Based on peer reviews of engagements with year-ends between March 31, 2014 and June 30, 2015, the items that follow were common examples of noncompliance (both material and immaterial) with professional standards. These items are updated quarterly and can be found at www.aicpa.org.

Common Peer Review Findings—Review Engagements

.87 The following headings represent the broad findings based on the data collected from the AICPA Peer Review Program, and the text within the following sections discusses the proper treatment of MFC forms in accordance with SSARS No. 21.

Management Representations—Omissions and Errors

.88 Paragraphs .32–.37 of AR-C section 90 provide the requirements with respect to written representations in a review engagement. Written

³ Additional resources from the *Journal of Accountancy*: Sarah Beckett Ference, "Failure to detect theft and fraud: It's not just an audit issue," February 2014; Sarah Beckett Ference, "Don't let scope creep lead you out of bounds," September 2015; Professional Liability Spotlight: "Buckle up: The importance of engagement letters," December 2014; Deborah K. Rood, "Billing for defense (and payment)," December 2013.

representations from management are required for all financial statements and periods covered by the accountant's review report. The accountant should request

- that management provide written representations that are dated as of the date of the accountant's review report.
- that management has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, as set out in the terms of the engagement.
- that management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud.
- that management has provided the accountant with all relevant information and access, as agreed upon in the terms of the engagement.
- that management has responded fully and truthfully to all of the accountant's inquiries.
- that all transactions have been recorded and are reflected in the financial statements.
- that management has disclosed to the accountant its knowledge of fraud or suspected fraud affecting the entity involving
 - management,
 - employees who have significant roles in internal control, or
 - others when the fraud could have a material effect on the financial statements.
- that management has disclosed to the accountant its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
- that management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations, whose effects should be considered when preparing financial statements.
- information about whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation.
- that management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- information about whether management believes that significant assumptions they use in making accounting estimates are reasonable.

- that management has disclosed to the accountant the identity of the entity's related parties and all of the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

.89 The representation letter ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

Basic Reporting Elements—Failure to Follow the Basic Report Elements

.90 Practitioners should note that financial statements reviewed by the accountant should be accompanied by a written report. As noted previously in paragraphs .39–.40, AR-C section 90 revised the requirements for reporting on review engagements. The basic elements of the report are as follows:

- Title
- Addressee
- Introductory paragraph
- Management's responsibility for the financial statements
- Accountant's responsibility
- Accountant's conclusion
- Signature of the accountant
- The city and state where the accountant practices
- Date of the accountant's report

Supplementary Information—Failure to Report the Degree of Responsibility Taken With Respect to Supplementary Information

.91 Paragraphs .80–.82 of AR-C section 90 provide the requirements with respect to supplementary information that accompanies reviewed financial statements. When supplementary information accompanies financial statements and the accountant's review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either an other-matter paragraph in the accountant's review report or in a separate report on the supplementary information.

Engagement Letters—Omissions and Errors

.92 Readers should refer to the "Current Practice Issues" section in this alert for information on engagement letters.

Review Documentation—Documentation of Expectations in Analytical Procedures

.93 According to paragraphs .19–.20 of AR-C section 90, the accountant is required to apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items

that appear to be unusual and may indicate a material misstatement. Such analytical procedures should include the following:

- a. Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions
- b. Considering plausible relationships among both financial and, when relevant, nonfinancial information
- c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates
- d. Comparing disaggregated revenue data, as applicable

.94 When designing and performing analytical procedures, the accountant should

- a. determine the suitability of particular analytical procedures;
- b. consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available;
- c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

.95 Paragraph .91 of AR-C section 90 requires the accountant to prepare review documentation that is sufficient to enable an experienced accountant having no previous connection to the review to understand the procedures performed by the accountant to comply with the requirements regarding analytical procedures, as mentioned previously.

Common Peer Review Findings—Compilation Engagements

.96 The following headings represent the broad findings based on the data collected from the AICPA Peer Review Program, and the text within the following sections discusses the proper treatment of MFC forms in accordance with SSARS No. 21.

Reporting on the Financial Statements—Failure to Include Basic Report Elements

.97 As noted previously in paragraphs .33–.34, AR-C section 80 revised the requirements for the accountant's compilation report. The accountant's compilation report should be in writing and should

- include a statement that management (owners) is (are) responsible for the financial statements.
- identify the financial statements that have been subjected to the compilation engagement.
- identify the entity whose financial statements have been subjected to the compilation engagement.
- specify the date or period covered by the financial statements.
- include a statement that the accountant performed the compilation engagement in accordance with SSARs promulgated by the Accounting and Review Services Committee of the AICPA.
- include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on the financial statements.
- include the signature of the accountant or the accountant's firm.
- include the city and state where the accountant practices.
- include the date of the report, which should be the date that the accountant has completed the procedures required by AR-C section 80.

Supplementary Information—Failure to Report the Degree of Responsibility Taken With Respect to Supplementary Information

.98 Paragraphs .32–.34 of AR-C section 80 provide the requirements with respect to supplementary information that accompanies financial statements and the accountant's compilation report thereon. When supplementary information accompanies financial statements and the accountant's compilation report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either an other-matter paragraph in the accountant's compilation report or in a separate report on the supplementary information.

Reporting on the Financial Statements—Failure to Report That Substantially All Required Disclosures Have Been Omitted

.99 In accordance with paragraph .25 of AR-C section 80, when reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements:

- a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with a special purpose framework)
- b. A statement that if the omitted disclosures (and the statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the entity's financial position, results of operations, and cash flows (or the equivalent

for presentations other than generally accepted accounting principles [GAAP])

- c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

Engagement Letters—Omissions and Errors

.100 Readers should refer to the section "Current Practice Issues" in this alert for information on engagement letters.

► AICPA Peer Review Program: Training and frequently asked questions about the AICPA Peer Review program can be found at www.aicpa.org. Questions can also be directed to the Peer Review Hotline at 919.402.4502 or prptechnical@aicpa.org.

Recent Activities of FASB's Private Company Council

.101 In May 2012, the Financial Accounting Foundation's Board of Trustees approved the establishment of the Private Company Council (PCC) to improve the standard-setting process for private companies. The PCC will develop, deliberate, and formally vote on proposed alternatives for private companies within U.S. GAAP. FASB and the PCC will also consider private company issues in standard-setting projects under active consideration on FASB's technical agenda.

Intangible Assets in a Business Combination

.102 In December 2014, FASB issued ASU No. 2014-18, *Business Combinations (Topic 805): Accounting for Identifiable Intangible Assets in a Business Combination (a consensus of the Private Company Council)*. According to this ASU, the PCC added this issue to its agenda in response to feedback from some private company stakeholders that indicated that the benefits of the current accounting for identifiable intangible assets acquired in a business combination may not justify the related costs. This update provides an accounting alternative that reduces the cost and complexity associated with the measurement of certain identifiable intangible assets without significantly diminishing decision-useful information to users of private company financial statements.

.103 The accounting alternative applies when an entity is required to recognize or otherwise consider the fair value of intangible assets as a result of any one of the following transactions:

- a. Applying the acquisition method under FASB ASC 805, *Business Combinations*
- b. Assessing the nature of the difference between the carrying amount of an investment and the amount of the underlying equity in net assets of an investee when applying the equity method under FASB ASC 323, *Investments—Equity Method and Joint Ventures*
- c. Adopting fresh-start reporting under FASB ASC 852, *Reorganizations*

.104 An entity that elects this accounting alternative to recognize or otherwise consider the fair value of intangible assets as a result of any in-scope

transactions should no longer recognize separately from good will (1) customer-related intangible assets unless they are capable of being sold or licensed independently from the other assets of the business and (2) noncompetition agreements.

.105 An entity that elects this accounting alternative must adopt the private company accounting alternative to amortize goodwill as described in ASU No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council)*. You can view the full text of this ASU at www.fasb.org.

Accounting for Goodwill

.106 In January 2014, FASB issued ASU No. 2014-02. According to this ASU, the PCC obtained feedback from private company stakeholders that the benefits of the current accounting for goodwill after initial recognition do not justify the related costs. The PCC decided that the concerns expressed about the cost and complexity encountered when applying the current goodwill accounting guidance and the limited relevance to users indicated that a change to the accounting for goodwill was warranted.

.107 This ASU permits a private company to subsequently amortize goodwill on a straight-line basis over a period of 10 years, or less, if the company demonstrates that another useful life is more appropriate. It also permits a private company to apply a simplified impairment model to goodwill. Goodwill is the residual asset recognized in a business combination after recognizing all other identifiable assets acquired and liabilities assumed.

.108 The accounting alternative, if elected, should be applied prospectively to goodwill existing as of the beginning of the period of adoption and new goodwill recognized in annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early application is permitted, including application to any period for which the entity's annual or interim financial statements have not yet been made available for issuance. You can view the full text of this ASU at www.fasb.org.

Simplified Hedge Accounting

.109 In January 2014, FASB issued ASU No. 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach (a consensus of the Private Company Council)*. According to this ASU, the PCC received input through outreach indicating that private companies often find it difficult to obtain fixed-rate borrowing. Some private company stakeholders contend that because of limited resources and the fact that hedge accounting is difficult to understand and apply, many private companies lack the expertise to comply with the requirements to qualify for hedge accounting. Therefore, they do not elect to apply hedge accounting, which results in income statement volatility.

.110 This ASU gives private companies—other than financial institutions—the option to use a simplified hedge accounting approach to account for swaps that are entered into for the purpose of economically converting a variable-rate borrowing into a fixed-rate borrowing. Under this approach, the income statement charge for interest expense will be similar to the amount that would result if the entity had directly entered into a fixed-rate borrowing

instead of a variable-rate borrowing and a receive-variable, pay-fixed interest rate swap.

.111 The simplified hedge accounting approach will be effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015, with early adoption permitted. Private companies have the option to apply the amendments in this ASU using either the (a) modified retrospective approach or the (b) full retrospective approach. These two approaches are described in further detail in the full text of the ASU at www.fasb.org.

Variable Interest Entities

.112 In March 2014, FASB issued ASU No. 2014-07, *Consolidation (Topic 810): Applying Variable Interest Entities Guidance to Common Control Leasing Arrangements (a consensus of the Private Company Council)*. According to this ASU, the PCC added this issue to its agenda in response to feedback from private company stakeholders that indicated that the benefits of applying variable interest entity (VIE) guidance to a lessor entity under common control does not justify the related costs. The PCC decided that the concerns expressed about the cost and complexity of applying VIE guidance and the lack of relevance to users when consolidating lessor entities under common control indicated that a change to VIE guidance should be explored. The PCC reached a consensus to provide an elective accounting alternative for private companies in applying VIE guidance to lessor entities under common control, leading to the issuance of this ASU.

.113 The amendments permit a private company lessee (the reporting entity) to elect an alternative not to apply VIE guidance to a lessor entity if

- the private company lessee and the lessor entity are under common control;
- the private company lessee has a lease arrangement with the lessor entity;
- substantially all the activities between the private company lessee and the lessor entity are related to leasing activities (including supporting leasing activities) between those two entities; and
- if the private company lessee explicitly guarantees or provides collateral for any obligation of the lessor entity related to the asset leased by the private company, then the principal amount of the obligation at inception of such guarantee or collateral arrangement does not exceed the value of the asset leased by the private company from the lessor entity.

.114 Examples of supporting leasing activities between the private company lessee and the lessor entity include issuance of a guarantee and provision of collateral on the obligations of the lessor entity that are related to the asset(s) leased to the private company lessee.

.115 If elected, the accounting alternative should be applied retrospectively to all periods presented. The alternative will be effective for annual periods beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early application is permitted, including application to any period for which the entity's annual or interim

financial statements have not yet been made available for issuance. See the full text of this ASU at www.fasb.org.

On the Horizon

.116 This alert identifies certain developments and standard-setting activities that are of particular importance to preparation, compilation, and review engagements. The following sections present brief information about some ongoing projects that have particular significance to preparation, compilation, and review engagements. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.117 Information on, and copies of, outstanding exposure drafts may be obtained from the various standard-setters' websites. These websites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers may refer to the Audit Risk Alert *General Accounting and Auditing Developments—2015/16* (product nos. ARAGEN15P, ARAGEN15E, or WGE-XX), for further information.

ASU No. 2014-15

.118 In August 2014, FASB issued ASU No. 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern*. The summary section of this ASU notes that the board received input indicating that because of the lack of guidance in GAAP and the differing views about when there is substantial doubt about an entity's ability to continue as a going concern, there is diversity in whether, when, and how an entity discloses the relevant conditions and events in its note disclosures. This ASU provides that guidance and should reduce diversity in the timing and content of footnote disclosures. This ASU requires management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles currently in U.S. auditing standards. Specifically, this ASU

- a. provides a definition of the term *substantial doubt*;
- b. requires an evaluation every reporting period, including interim periods;
- c. provides principles for considering the mitigating effect of management's plans;
- d. requires certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans;
- e. requires an express statement and other disclosures when substantial doubt is not alleviated; and
- f. requires an assessment for a period of one year after the date that the financial statements are issued (or available to be issued).

.119 ASU No. 2014-15 is effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted.

Proposed SSARS on Preparation and Compilation of Prospective Financial Information and Proposed SSARS on Compilation of Pro Forma Financial Information

.120 ARSC is currently considering drafts of proposed standards that address the preparation and compilation of prospective financial information. ARSC expects to expose the proposed standards for public comment during the fourth quarter of 2015. At that time, ARSC will also expose for public comment the proposed clarified AR section 120 on compilation of pro forma financial information and certain minor revisions to SSARS No. 21.

.121 Currently, requirements and guidance with respect to compilations of prospective financial information resides in AT section 301, *Financial Forecasts and Projections* (AICPA, *Professional Standards*). As part of its project to clarify the attestation literature, the Auditing Standards Board made the decision to remove the guidance regarding compilations of prospective financial information from the attestation standards because compilations are not attestation engagements as defined in the proposed revision of AT section 101, *Attest Engagements* (AICPA, *Professional Standards*).

Resource Central

.122 The following are various resources that practitioners and accounting professionals may find beneficial.

Publications

.123 Practitioners and accounting professionals may find the following publications useful. Choose the format best for you—online, e-book, or print.

- *Codification of Statements on Standards for Accounting and Review Services* (product no. ACODSSARS15P [paperback] or ACODSSARS15E [e-book])
- AICPA Guide *Preparation, Compilation, and Review Engagements* (2015) (product no. AAGCRV15P [paperback] WRCXX [online] or AAGCRV15E [e-book])
- AICPA Practice Aid *Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements* (product no. APACTB12P [paperback], APACTBO [online], or APACTB12E [e-book])
- Alert *Independence and Ethics Developments—2014/15* (product no. ARAIET14P [paperback], WIA-XX [online], or ARAIET14E [e-book])
- AICPA Guide 2015 *Preparation, Compilation, and Review Engagements*, AICPA Guide 2014 *Compilation and Review Engagements*, *Developments in Review, Compilation, and Financial Statement Preparation Engagements*, and *Codification of Statements on Standards for Accounting and Review Services Set* (product no. WSR-XX)
- U.S. GAAP *Financial Statements—Best Practices in Presentation and Disclosure* (formerly, *Accounting Trends & Techniques*) (product no. ATTATT15P [paperback] or ABPPDO [online])

- *Financial Reporting Framework for Small- and Medium-Sized Entities with Implementation Resources* (product no. AFRF-SME13E [e-book] or AFRFSMEO [online])

The Engagement Letter: Best Practices and Examples

.124 *The Engagement Letter: Best Practices and Examples* tool provides guidance on developing engagement letters in accordance with applicable AICPA professional standards. Offered in a convenient and efficient online format, subscribers to this tool can download the sample engagement letters for easy mark up and customization.

FRF for SMEs Toolkits

.125 The AICPA has developed free FRF for SMEs™ toolkits to help CPAs and CPA firms, financial statement users, and small businesses learn about the FRF for SMEs reporting option. These toolkits contain overviews, sample illustrative financial statements, videos, PowerPoint presentations, and much more. There are three toolkits available: one for CPAs, one for financial statement users, and one for small businesses.

.126 All of the resources are available free of charge at www.aicpa.org/frc.

Decision Tool for Adopting FRF for SMEs

.127 The AICPA has developed a tool to help owners and managers of a small- or medium-sized private business and CPAs serving those businesses to make an informed decision about choosing an accounting framework, including the FRF for SMEs framework, as an appropriate basis for the preparation of the entity's financial statements. The choice of a financial reporting framework rests with the owners and managers of a private company, in consideration of their needs and the needs of the users of their financial information. Readers should note that the tool is presented as a nonauthoritative aid, and its use is not required. The tool is available online to AICPA members at the AICPA's Financial Reporting Center at www.aicpa.org/frc.

Continuing Professional Education

Self-Study Print CPE

.128 The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry, including the following specifically related to engagements performed in accordance with SSARs:

- Engagement Essentials: Preparation of Financial Statements (product no. 733530 [text])
- Engagement Essentials: Compilation of Financial Statements (product no. 733629 [text])
- Engagement Essentials: Review of Financial Statements (product no. 733376 [text])
- Engagement Essentials: Preparation, Compilation, and Review of Financial Statements (product no. 746101)
- Compilation, Preparation, and Review Engagements Update (product no. 733378 [text])

- Annual Update for Preparation, Compilation, and Review Engagements (product no. 746061 [text])
- Advanced Issues in Preparation, Compilation, and Review Engagements (product no. 733387 [text]; 163090 [online])

.129 Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

CPEExpress

.130 AICPA CPEExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPEExpress offers hundreds of hours of learning in a wide variety of topics. Subscriptions are available at www.cpa2biz.com.

Online Curriculum

.131 Preparation, Compilation, and Review Staff Essentials is a new curriculum that has been designed to provide a convenient, accessible way for firms to train their staff on how to perform preparation, compilation, and review engagements. This curriculum combines real-world examples, practice exercises, case studies, and a learning coach to create a flexible, engaging learning experience. The full curriculum comprises 9 courses that total 17 hours of CPE credit. There are also two series in the curriculum: the Review Engagements Series and the Compilation and Preparation Engagements Series. The 9 courses can also be purchased individually. Visit www.cpa2biz.com for the full curriculum description.

Webcasts

.132 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived. For additional details on available webcasts, please visit www.cpa2biz.com.

Member Service Center

.133 To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Center Operations at 888.777.7077.

Hotlines

Accounting and Auditing Technical Hotline

.134 Do you have a complex technical question about reviews, compilations, and engagements to prepare financial statements or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. ET on weekdays. You can reach the Technical Hotline at 877.242.7212 or online at www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx. Members can also email

questions to aahotline@aicpa.org. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

Ethics Hotline

.135 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at 888.777.7077 (press "6" and then "1" on your phone's keypad) or by email at ethics@aicpa.org.

The AICPA Center for Plain English Accounting

.136 The Center for Plain English Accounting (CPEA) is a new service available to PCPS member firms. They provide expertise and resources in a straight-forward and clear style. Written responses to technical inquiries, webcasts on hot topics, and monthly A&A reports and alerts are helping practitioners understand and implement the authoritative professional literature with respect to audits, reviews, compilations, and preparation of financial statements. To join the CPEA and take advantage of these valuable resources and guarantee your practice one seat at eight annual webcasts (16 CPE credits), go to www.aicpa.org/CPEA.

AICPA Online Professional Library: Accounting and Auditing Literature

.137 The AICPA has created your core accounting and auditing library online. The AICPA Online Professional Library is now customizable to suit your preferences or your firm's needs. You can also sign up for access to the entire library. Get access anywhere that you can get online to the FASB *Accounting Standards Codification*®; the AICPA's latest *Professional Standards*, *Technical Questions and Answers*, Audit and Accounting Guides, Audit Risk Alerts, Best Practices in Presentation and Disclosure; and more. To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

AICPA Practice Aid Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements

.138 The AICPA has available a practice aid *Accounting and Financial Reporting Guidelines For Cash- and Tax-Basis Financial Statements* that provides preparers with the guidelines and best practices to promote consistency and help resolve the often difficult questions regarding the preparation of cash- and tax-basis financial statements. Although nonauthoritative, this practice aid is the best source for such guidance. You can order this practice aid from cpa2biz.com (product no. APACTB15P [paperback]; APACTB15E [e-book]; APACTBO [online]).

Financial Reporting Center of AICPA.org

.139 CPAs face unprecedented changes in financial reporting. As such, the AICPA has created the Financial Reporting Center to support you in the execution of high-quality financial reporting. This center provides exclusive member-only resources for the entire financial reporting process and can be accessed at www.aicpa.org/frc.

.140 The Financial Reporting Center provides timely and relevant news, guidance, and examples supporting the financial reporting process. You will find resources for accounting, preparing financial statements, and performing various types of engagements, including compilation and review, audit and attest, and assurance and advisory.

.141 For example, the Financial Reporting Center offers a dedicated section to Review, Compilation, and Preparation engagements. For the latest resources available to help you implement the clarified standards, visit the "Review, Compilation, and Preparation" page at www.aicpa.org.

Appendix A—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants who perform reviews, compilations, and engagements to prepare financial statements, as well as management of entities for whom such engagements are performed.

<i>Website Name</i>	<i>Content</i>	<i>Website</i>
AICPA	Summaries of professional standards as well as other AICPA activities.	www.aicpa.org www.cpa.com www.ifrs.com
AICPA Standards and Statements	One central location to access the standards and statements that the AICPA develops, issues, and enforces. Includes the following: <ul style="list-style-type: none"> • Statements on Standards for Accounting and Review Services • Auditing standards • Quality Control standards • Code of Professional Conduct • Peer Review standards 	www.aicpa.org/Research/Standards/Pages/default.aspx
AICPA Financial Reporting Center	Summaries of AICPA standard-setting activity, recently issued technical Q&As, and financial reporting news. Links to other information related to accounting and financial reporting; audit and attest services; review, compilation, and financial statement preparation engagement services; and assurance and advisory services.	www.aicpa.org/frc

Website Name	Content	Website
AICPA Accounting and Review Services Committee	Summaries of standards for reviews, compilations, and engagements to prepare financial statements.	www.aicpa.org/Research/Standards/CompilationReview/ARSC/Pages/ARSC.aspx
ARSC Clarity Project	Information with respect to ARSC's project to clarify standards for preparation, compilation, and review engagements.	www.aicpa.org/InterestAreas/FRC/ReviewCompilationPreparation/Pages/ARSCClarityProject.aspx
AICPA Professional Ethics Executive Committee	AICPA technical committee charged with the responsibility of interpreting and enforcing the AICPA Code of Professional Conduct.	www.aicpa.org/InterestAreas/ProfessionalEthics/Pages/ProfessionalEthics.aspx
AICPA Financial Reporting Executive Committee	AICPA technical committee for financial reporting. Its mission is to determine the AICPA's technical policies regarding financial reporting standards and to be the AICPA's spokesperson on those matters, with the ultimate purpose of serving the public interest by improving financial reporting.	www.aicpa.org/InterestAreas/frc/AccountingFinancialReporting/Pages/FinREC.aspx
Economy.com	Source for analyses, data, forecasts, and information on the U.S. and world economies.	www.economy.com
The Federal Reserve Board	Source of key interest rates.	www.federalreserve.gov
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities.	www.fasb.org
USA.gov	Portal through which all government agencies can be accessed.	www.usa.gov

<i>Website Name</i>	<i>Content</i>	<i>Website</i>
Government Accountability Office	Policy and guidance materials and reports on federal agency major rules.	www.gao.gov
Governmental Accounting Standards Board (GASB)	Summaries of recent accounting pronouncements and other GASB activities.	www.gasb.org
International Accounting Standards Board	Summaries of International Financial Reporting Standards and International Accounting Standards.	www.iasb.org
International Auditing and Assurance Standards Board	Summaries of International Compilation and Review Standards.	www.iaasb.org
International Federation of Accountants	Information on standard-setting activities in the international arena.	www.ifac.org
Private Company Financial Reporting Committee	Information on the initiative to further improve FASB's standard-setting process to consider needs of private companies and their constituents of financial reporting.	www.pcfr.org

