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PROPOSED GUIDE FOR PROSPECTIVE FINANCIAL STATEMENTS

Table of Contents

* Not included.

GENERAL

Section 100 **Preface**

.01 Prospective financial information is of interest to a broad spectrum of parties including management, present or potential owners of equity interests, credit grantors and other informed third parties, government agencies, and the public. This guide represents another of the AICPA's efforts to provide information and guidance to those interested in prospective financial information.

.02 This guide was prepared to establish guidelines for the preparation and presentation of financial forecasts and projections (sometimes referred to as prospective financial statements). The guide is also intended to assist the accountant in performing professional services and reporting on such statements.

.03 Preparation and presentation of financial forecasts and guidelines for their preparation had been previously addressed in Management Advisory Services Guideline Series No. 3 ("Guidelines for Systems for the Preparation of Financial Forecasts"), and Statement of Position 75-4 ("Presentation and Disclosure of Financial Forecasts"), respectively. Although the above documents are superseded by this guide, the information previously provided in those documents has been expanded to include financial projections and appears as sections 300 and 400, respectively.

Structure of the Guide

.04 The guide covers both financial forecasts and financial projections. However, its primary focus is on financial forecasts because they more closely parallel historical financial statements, which are intended to provide the financial information needed by persons making financial decisions but who do not have access to the entity's records or management. Financial forecasts provide a framework for prospective reporting from which principles for financial projections are derived. Thus, the guide first presents the principles relating to financial forecasts and then shows how those principles are modified for financial projections.

.05 The guide comprises six major areas. The first area, sections 100-220, consists of general information, which is of interest to all users of the guide. The second area, sections 300-410, is intended for preparers and issuers of financial forecasts and provides guidance on preparation and presentation. The third area, sections 500-730, contains guidance for accountants who perform professional services with respect to financial forecasts. The fourth area, sections 1100-1730, explains how financial projections differ from forecasts and how the guidance in the second and third areas should be modified when preparing, issuing, or providing services on projections. The fifth area, section 2000, provides some guidance as to the accountant's association with partial presentations, which are not covered in detail in this guide. The sixth area, appendices A, B, and C, provides background information on the SEC's policies on projections and its safe harbor rule for projections, and the Treasury Department's proposed regulations on Circular 230.

.06 The guidance contained in sections 300-730 generally also applies to financial projections. Certain paragraphs in those sections, however, do not apply - partially or fully - to projections and are indicated by an asterisk (*) preceding the paragraph. In those instances, the reader should refer to the corresponding section (sections 1300-1730) in the area on financial projections.

Section 110 Scope

Prospective Financial Statements[1/]

.01 This guide deals with prospective financial statements. These presentations may comprise prospective statements of financial position, results of operations, changes in financial position, and summaries of significant assumptions and significant accounting policies. These presentations may also be limited to those items discussed in section 400.03. A presentation that does not meet the minimum standards of section 400, Presentation of Financial Forecasts, including presentations limited to specified elements or accounts, is considered a partial presentation. Although this guide is not intended to provide comprehensive guidance as to partial presentations, section 2000, Partial Presentations, discusses the accountant's association with such information.

.02 Prospective financial information may be referred to by a number of different names, such as forecasts, projections, feasibility studies, break-even analyses, and budgets. Whatever such prospective financial information is called, if the presentation fits the description of prospective financial statements, it is covered by this guide.

.03 Some financial presentations are designed to demonstrate the impact of a future or hypothetical transaction by showing how it might have affected the historical financial statements if it had been consummated during the period covered by those statements. These presentations are commonly called "pro forma financial statements". Although the transactions in question are prospective and such presentations may look like those described in this guide, the guide does not apply to those presentations because they are essentially historical statements and do not purport to be prospective financial statements.

Preparation and Presentation by Management

.04 This guide provides the following information for entities presenting prospective financial statements:

- o Guidelines for designing a system for preparation of prospective financial statements and, alternatively, guidelines for preparing such presentations without the benefit of a formal system.
- o Guidelines for presentation of prospective financial statements.

Accountant's Services

.05 Accountants are sometimes engaged for the expressed purpose of compiling or reviewing prospective financial statements. Often, however, they are engaged to assist their clients in other areas, for example in obtaining financing, deciding whether to lease or buy an asset, consummating a merger or acquisition, determining the tax consequences of future actions, or planing future operations and in providing such services become involved with prospective financial statements. This guide comprehends two professional services that accountants may provide with respect to prospective

1/ See definition of prospective financial statements, section 200.07.

financial statements, whatever the objective of the engagement: compilation and independent review. The meanings of the terms "compilation" and "review" as used in this guide differ somewhat from the meanings of those terms in Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements and SAS No. 36, Review of Interim Financial Information. The procedures for these services as regards prospective financial statements are different than for historical financial statements because the nature of prospective information is different from the nature of historical information (see sections 120.04-.06).

.06 The accountant may perform procedures to achieve the engagement's objectives that exceed the procedures discussed in this guide. For example, the guide is not intended to cover all aspects of performing feasibility studies, although feasibility studies often contain prospective financial statements. However, if an accountant provides services on a feasibility study that includes prospective financial statements, then this guide applies to that service and resulting report (section 720.22 illustrates a report on a review of a financial forecast contained in a feasibility study).

.07 Accountants may be engaged to provide a variety of services relating to prospective financial information, such as providing assistance in developing forecasting systems and identifying factors to be considered in developing prospective financial statements. This guide is not intended to provide comprehensive guidance as to such services.2/

.08 With a view towards providing guidance in additional areas, the AICPA is studying other forms of prospective financial information and accountants' services with respect to such information. Until such guidance is available, an accountant who is engaged to perform services on partial presentations should refer to section 2000, Partial Presentations, of this guide.

Litigation Support Services

.09 Sometimes, accountants are associated with prospective financial statements that may be used in a pending or potential formal legal proceeding before a "trier of fact" in connection with the resolution of a dispute between two or more parties. These services are often called "litigation support services".

.10 This guide applies to such services involving prospective financial statements to the extent that it can be practically applied. However, in some cases it may be impractical to apply all the guidance contained herein. For example, if the accountant provides srevices on the forecast of his client's adversary it would be impractical for him to apply any procedures requiring access to the adversary's records or to obtain signed representations from the adversary; or the court may compel the accountant to report orally rather rather than in writing.

.11 The accountant who performs litigation services should also refer to Ethcis rule 201(e) (see section 2000.05).

2/ However, see section 500 for a discussion of when the accountant is associated with prospective financial statements and his responsibilities when he is so associated.

Section 120 Background and History

Prior Authoritative Literature

.01 The American Institute of Certified Public Accountants had previously issued the following documents containing guidance on financial forecasts: Guidelines for Systems for the Presentation of Financial Forecasts, Management Advisory Services Guideline Series No. 3 (March 1975), issued by the AICPA Management Advisory Services Division; Presentation and Disclosure of Financial Forecasts, Statement of Position 75-4 (August 1975), issued by the AICPA Accounting Standards Division; Guide for a Review of a Financial Forecast (October 1980) and Statement of Position, Report on a Financial Feasibility Study (October 1982) prepared by the Financial Forecasts and Projections Task Force. Those documents are superseded by this guide.

.02 The Securities and Exchange Commission (SEC) permits the publication of prospective information under certain conditions and has adopted the general policy of encouraging such publication. The SEC has indicated that companies that include prospective financial information in SEC filings or annual reports should meet certain broad standards and disclosure requirements. In addition, the SEC adopted a rule that essentially provides a safe harbor for statements made by or on behalf of companies that issue prospective information or by an outside reviewer unless such statements were (a) made in other than good faith or (b) disclosed without a reasonable basis. The SEC Policy on Projections and the Safe Harbor Rule for Projections are included in appendices A and B, respectively.

.03 The Department of the Treasury has issued proposed regulations on Circular 230 involving tax shelter opinions. The proposed regulations provide that when an accountant provides a tax shelter opinion, he should, where possible, provide an opinion whether it is more likely than not that an investor will prevail on the merits of each material tax issue and an overall evaluation of the extent to which the material tax benefits are likely to be realized in the aggregate. The Treasury Department's modified proposed regulations on Circular 230 are included in Appendix C.

Nature of Prospective Financial Statements

.04 Prospective financial statements are based on assumptions regarding future events. The assumptions are, in turn, based on a combination of available information and judgment in which both history and plans play a part.

.05 As no one can know the future and prospective financial statements may be affected by many factors internal and external to the entity, judgment must be applied to estimate when and how conditions are likely to change. These judgments may subsequently prove to be unrepresentative of future conditions; thus the achievability and reliability of prospective financial statements can never be guaranteed.

.06 Prospective financial information is substantially less subject to objective verification than historical data. When working with or using prospective information, it is essential to understand the inherent limitations of such information.

Section 200 Definitions

.01 Certain terms are defined as follows for the purposes of this guide.

.02 Prospective financial information is any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

.03 A financial forecast is prospective financial information that presents, to the best of the responsible party's knowledge, an entity's expected financial position, results of operations, and changes in financial position. It is based on the responsible party's assumptions reflecting conditions it expects to exist and the course of action it expects to take. Minimum presentation guidelines are prescribed in section 400.03.

.04 A financial projection is prospective financial information that presents, to the best of the responsible party's knowledge, an entity's expected financial position, results of operations, and changes in financial position given one or more hypothetical assumptions. It is based on the responsible party's assumptions reflecting conditions it expects would exist and the course of action it expects would be taken, given one or more hypothetical assumptions. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question such as "What would happen if...?" Minimum presentation guidelines are prescribed in section 400.03.

.05 An entity is any unit, existing or to be formed, for which financial statements could be prepared in accordance with generally accepted accounting principles or other comprehensive basis of accounting.[1] For example, an entity can be an individual, partnership, corporation, trust, estate, or association.

.06 A hypothetical assumption is an assumption used in a financial projection to present a condition or course of action that is not necessarily expected to occur, but is consistent with the purpose of the projection.

.07 Prospective financial statements are either financial forecasts or projections. While prospective financial statements may cover a period that has partially expired, statements for periods that have completely expired are not considered prospective financial statements for the purpose of this guide. Prospective financial statements also exclude pro forma financial statements (see section 110.03) and partial presentations.

.08 Partial presentations are presentations of prospective financial information that do not include at least the minimum items described in section 400.03.

.09 A multiple projection is a presentation of two or more financial projections in which the responsible party selects the hypothetical assumptions to form a range within which it reasonably expects, to the best of its knowledge, the result for those assumptions to fall. A multiple projection, as used in this guide, does not refer to a presentation of more than one projection used to analyze several alternative hypothetical courses of action (although such a presentation is also covered by the guide).

1/ SAS No. 14 discusses comprehensive bases of accounting other than generally accepted accounting principles.

.10 Management refers to those who are expected to direct the operations of the entity during the prospective period. Management typically refers to those people at the highest level of authority within the entity.2/

.11 Responsible party refers to the person or persons who take responsibility for the assumptions underlying the prospective financial statements.3/ The responsible party usually is management but can be persons outside of the entity not currently having the responsibility to direct operations (for example, a party considering acquiring the entity).

.12 A review of prospective financial statements is a professional service that provides the accountant with a basis for reporting whether:

- the presentation was properly prepared based on the stated underlying assumptions, and
- the presentation conforms with AICPA presentation guidelines, and
- the underlying assumptions provide a reasonable basis for the presentation.

.13 A compilation of prospective financial statements is a professional service that involves assembly of prospective financial statements and consideration of whether the assumptions or presentation are obviously inappropriate but on which the accountant expresses no conclusion or any other assurance.

.14 Assembly means the performance of mathematical or other clerical functions related to the presentation of the prospective financial statements. Assembly does not refer to the mere reproduction and collation of such statements.

.15 Key factors are the significant matters on which an entity's future results are expected to depend. Such factors are basic to the entity's operations and thus encompass matters that affect, among other things, the entity's sales, production, service, and financing activities. Key factors serve as a foundation for prospective financial statements and are the bases for the assumptions.

2/If the entity is to be formed in the future, the term "management" includes the promoters or other individuals who expect to be responsible for directing the operations of the entity.

3/ See section 220.

Section 210 Types of Prospective Financial Statements and Their Uses

.01 Entities prepare prospective financial statements for a variety of reasons. For example, an entity may want to obtain external financing, consider a change in operations or accounting, or prepare a budget. The reason the prospective financial statements are prepared determines the type of prospective statements developed.

.02 Prospective financial statements can be for either general use or limited use. This section dicusses the differences between the two uses and the types of presentations that are appropriate for those uses.

.03 General use of prospective financial statements refers to use of the statements in a solicitation to invest in the debt or equity of the entity made to persons with whom the responsible party is not negotiating directly (also called a general offering of debt or equity). Examples of general uses are tax exempt bond offerings and tax shelter limited partnership offerings.

.04 Limited use of prospective financial statements refers to use of the statements by the entity alone or by the entity and parties with whom it is dealing directly. Examples of limited uses are negotiations for a bank loan (with one bank or a series of banks), submission to a regulatory agency, and use solely within the entity.

General Use

.05 Because recipients of prospective financial statements distributed for general use are unable to ask the responsible party directly about the presentation or negotiate the terms of the offering, the presentation most useful to them is one that portrays the expected results of the entity. Accordingly, a financial forecast is appropriate for general use.

.06 If the responsible party is unable to prepare a financial forecast because of uncertainty about one or more assumptions, it may present a multiple projection for general use. In such a presentation, the responsible party presents two or more financial projections containing hypothetical assumptions in place of those assumptions it cannot develop to depict its expected conditions or course of action. The hypothetical assumptions are selected so that the responsible party, to the best of its knowledge, reasonably expects the results for the hypothetical assumptions to fall within the range presented.

.07 A single financial projection standing alone would be inappropriate for general use but might be used to supplement a financial forecast or a multiple projection in an offering document.

Limited Use

.08 Third party recipients of prospective financial statements intended for limited use can ask questions of the responsible party or negotiate terms directly with it and in some cases the responsible party will be the only user of the prospective financial statements. Accordingly, the involved parties may decide together on the form or presentation and assumptions to be used.

.09 Any type of prospective financial statements that would be useful in the circumstances would normally be appropriate for limited use. The presentation may be a financial forecast, a single financial projection, or a multiple projection.1/

Summary

.10 To summarize, the following types of prospective financial statements may be appropriate for the two types of uses shown:

General Use	Limited Use
financial forecast	financial forecast
multiple projection	financial projection
	multiple projection

1/ Partial presentations may be appropriate for limited use, however this guide is primarily concerned with prospective financial statements, not partial presentations.

Section 220 Responsibility for Prospective Financial Statements

.01 Prospective financial statements, including the underlying assumptions, are the responsibility of the entity's responsible party.[1] The responsible party cannot guarantee the achievement of the financial results set forth in the prospective financial statements because achievability depends on many factors that are outside of its control.

.02 The responsible party may influence the operations of an entity through planning, organizing, controlling, and directing its activities and, therefore, is in a position to develop reasonable or appropriate assumptions in respect to key factors.

.03 The responsible party may enlist the assistance of outside parties in preparing prospective financial statements. For example, an accountant may provide such assistance by helping the responsible party identify assumptions, gather information or assemble the statements. The accountant may also be engaged to develop a financial model so that the responsible party or others may consider the results using a variety of assumptions. If, as a result of performing these services, the accountant is associated with the prospective financial statements (see section 500) he should report as described in this guide. Such activities, however, ordinarily would not affect the accountant's objectivity in reviewing the prospective financial statements.[2]

.04 Regardless of the extent of the accountant's participation, the assumptions remain the responsibility of the responsible party. The accountant may assist in the formulation of assumptions, but the responsible party must evaluate the assumptions, make key decisions, and adopt and present the assumptions as its own.

.05 Since the accountant does not take responsibility for the assumptions, his review or compilation (including assembly) of an entity's prospective financial statements would not, per se, affect his independence with regard to services on its historical financial statements.

1/See the definition of "responsible party" in section 200.11.

2/Some of these services may not be appropriate if the accountant is to be named as a reviewer in a filing with the Securities and Exchange Commission. The SEC's Releases 33-5992 and 34-15305 on Disclosure of Projections of Future Economic Performance state that, for forecasts filed with the commission, "a person should not be named as an outside reviewer if he actively assisted in the preparation of the projection."

GUIDANCE FOR ENTITIES THAT ISSUE FINANCIAL FORECASTS

Section 300 Preparation of Financial Forecasts

Introduction

.01 This section provides guidance to the responsible party for preparing financial forecasts. These guidelines are applicable generally but the organizational and procedural means of applying them may differ from case to case because of the circumstances involved.

.02 An entity can prepare financial forecasts without adhering to all the guidelines in this section. The use of a process that incorporates these guidelines, however, often results in the development of more reliable prospective data than preparing financial forecasts without such a process. In addition to providing better management data, the use of such a process facilitates an independent accountant's review of the resulting financial forecasts.

.03 A process for preparing financial forecasts may include any of the following:

- o a formal system
- o performance of a work program that outlines the steps followed in preparation
- o the documented procedures, methods, and practices used in preparation.

The type of process used in preparing financial forecasts normally depends on the circumstances. In some cases the complexity of the data involved or regular use of the process may require a formal system. In many cases, however, the cost of a formal system exceeds the benefits derived from it and an entity can satisfactorily prepare financial forecasts using either of the other processes. The three types of processes are discussed in the following paragraphs.

.04 Financial forecasts may be prepared as the output of a formal system. A formal system consists of a set of policies, procedures, methods, and practices systematically applied by qualified personnel. It embraces inputs, processing, and outputs of the system and includes the collection, recording, analysis, interpretation, processing, and review of information concerning all elements of the enterprise.

.05 A formal system also consists of a set of related policies, procedures, methods, and practices that are used to prepare financial forecasts, monitor attained results relative to the forecasts, and prepare revisions or otherwise update the forecasts.

.06 Financial forecasts may also be prepared without benefit of a formal system. In such situations, a formal work program that outlines the steps followed in the preparation of the financial forecasts (which may be refined as work progresses) or a documentation of procedures, methods, and practices used in preparation, may be used in place of a formal system and still conform to these guidelines. If a work program is used it should provide for adequate definition of the procedures, methods, and practices to be employed.

.07 The guidelines in this section represent the elements that ideally would be included in a process to develop financial forecasts. However, even in the ideal, the guidelines would not need to be applied to immaterial items.

.08 The following is a summary of the guidelines for preparation of financial forecasts. These guidelines are discussed in the following sections:

Section	Guideline
310.	Financial forecasts should be prepared in good faith.
311.	Financial forecasts should be prepared with appropriate care by qualified personnel.
312.	Financial forecasts should be prepared using appropriate accounting principles.
* 313.	The process used to develop financial forecasts should provide for seeking out the best information reasonably available at the time.
* 314.	The information used in preparing financial forecasts should be consistent with the plans of the entity.
315.	Key factors should be identified as a basis for assumptions.
316.	Assumptions used in preparing financial forecasts should be appropriate.
317.	The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions.
318.	The process used to develop financial forecasts should provide adequate documentation of both the financial forecasts and the process used to develop the forecasts.
319.	The process used to develop financial forecasts should include, where appropriate, the regular comparison of the financial forecasts with attained results.
320.	The process used to prepare financial forecasts should include adequate review and approval by the responsible party at the appropriate levels of authority.

310. <u>Financial forecasts should be prepared in good faith.</u>

.01 The potential to mislead a third party reader of financial forecasts is greater than that for historical financial statements. Preparation of financial forecasts necessitates the use of judgment and the responsible party should make a good faith effort in preparing such statements. Good faith in this context includes making a diligent effort to develop appropriate assumptions (see sections 314 -317). Good faith also includes exercising care not to mislead a third party reader. Accordingly, financial forecasts should be presented in accordance with the presentation standards in this guide, including appropriate disclosures.

* .02 Because a financial forecast reflects the responsible party's estimate of financial results based on its plans, good faith precludes preparing them with either undue optimism or pessimism.

311. Financial forecasts should be prepared with appropriate care by qualified personnel.

.01 Appropriate care means that diligence and proper attention should be exercised in the preparation of the financial forecasts.

.02 The preparation of financial forecasts ordinarily involves the use of large amounts of data and requires a great many calculations. In addition, this data is processed without the benefit of the checks and balances inherent in an historical accounting system. These factors make the preparation of financial forecasts particularly susceptible to clerical error. Procedures should be established to facilitate the prevention, detection, and correction of such errors.

.03 The use of qualified personnel insures that appropriate knowledge and competence are present or acquired during the course of developing the financial forecasts. Personnel having competence in marketing, operations, finance, research and engineering, and other technical areas as appropriate under the circumstances should participate in the development of the financial forecasts.

.04 Analytical capability and expertise may be need to analyze and interpret relevant historical data. In some circumstances, expertise in technical forecasting and projection techniques and methodology may be required.

312. Financial forecasts should be prepared using appropriate accounting principles.

.01 The accounting treatment applied to events and transactions contemplated in financial forecasts should be the same as the accounting treatment expected to be applied in recording the events when or if they occur.

.02 Occasionally, a different basis of accounting is used in a financial forecast than is to be used for historical financial statements. For example, a cash basis statement may be prepared to determine cash flow. In these situations the process used to develop the financial forecast should provide a means for reconciling the prospective results with those that would be obtained using the basis of accounting used in historical financial statements.

.03 From time to time entities change the accounting principles they use. Such changes should be reflected in financial forecasts as they would in historical financial statements. (APB Opinion No. 20 states that there is a presumption in preparing financial statements that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. That presumption may be overcome only if the entity justifies the use of an alternative acceptable accounting principle on the basis that it is preferable.)

* .04 Since a financial forecast reflects an estimate of the entity's expected results, an accounting change should be reflected in the forecast only if the responsible party expects to make the change in the historical statements.

.05 When such changes in accounting treatment are contemplated, the process used to develop financial forecasts should include a means to reconcile the prospective results with those that would be obtained by using the accounting principles used in prior historical financial statements.

* 313. The process used to develop financial forecasts should provide for seeking out the best information reasonably available at the time.

.01 Information relevant to financial forecasts comes from many sources, both within and outside an entity. An effective process to develop financial forecasts should provide for searching out the best information reasonably available relevant to developing assumptions that are appropriate in relation to the presentation. The information used would include any relevant historical information.

.02 The acquisition of information ordinarily involves a cost. This cost should be commensurate with the anticipated benefits to be derived from the information. For example, the cost of making a survey may far exceed any potential benefit, even though the survey might provide the most precise information available. This section does not intend that information be acquired regardless of cost, although cost alone is not sufficient reason not to acquire needed information.

.03 Financial forecasts can be based only on information reasonably available at the time they are prepared. Often pertinent information becomes available only after financial forecasts have been completed or disclosed or after the prospective period has expired. The fact that information existed does not necessarily mean that it was available to the preparers of the financial forecasts.

.04 Various sources of information involve different degrees of reliability. The reliability of the basic data should be considered in the process of preparing the financial forecasts.

.05 A key consideration in the preparation of a financial forecast is the use of an appropriate level of detail. In certain situations the use of more detail may improve the reliability of financial forecasts. For example, forecasting sales by product line rather than in the aggregate may improve the forecast of sales, especially when the products sold are in different markets.

.06 However, situations also exist where the use of less detail or a more aggregated approach will improve reliability. For example, forecasting the cost for a common component contained in various product lines may be determined more effectively by grouping the product lines to ascertain the total quantity of the substance expected to be used.

* 314. The information used in preparing financial forecasts should be consistent with the plans of the entity.

.01 Financial forecasts should be consistent with the expected economic effects of anticipated strategies, programs, and actions, including those being planned in response to expected future conditions.

.02 An indication of the responsible party's plans can often be found in its budgets, goals, and policies. These sources of information should be considered in the preparation of financial forecasts. In considering these sources of information it should be determined if they are unduly optimistic or pessimistic and, if they are, that fact should be taken into account when preparing financial forecasts. Plans and budgets are more reliable and credible when developed through the use of effective planning and control systems. Sound reporting on a timely basis by functional responsibility together with effective planning and budgeting is the foundation of a process that develops financial forecasts.

315. Key factors should be identified as a basis for assumptions.

.01 Key factors are those matters upon which an entity's future results are expected to depend. These factors are basic to the entity's operations and serve as the foundation for the prospective financial statements. Key factors vary by entity and industry.

.02 All key factors should be identified in preparing financial forecasts. After such identification, assumptions should be developed for those key factors. For example, if a key factor is manufacturing labor, assumptions might be developed regarding manpower requirements and labor rates.

316. Assumptions used in preparing financial forecasts should be appropriate.

.01 Assumptions are the essence of developing financial forecasts and are the single most important determinant of such statements. The quality of the underlying assumptions largely determines the quality of financial forecasts.

.02 The attention devoted to the appropriateness of a particular assumption should be commensurate with the likely relative impact of that assumption on the prospective results. Assumptions with greater impact should receive more attention than those with less impact.

* .03 The assumptions should be reasonable and suitably supported. The level of support should be persuasive, although there are times when a number of assumptions in a narrow range of possibilities may appear equally likely.

.04 The nature of a business enterprise is such that many underlying assumptions are interrelated and certain of their elements may have multiple impacts. For example, a slowdown in economic activity will typically not only result in a slowdown in sales volume, but may also affect prices and the availability and cost of resources. The conditions assumed in arriving at the prospective sales or revenue data should be consistent with those assumed in developing the prospective financial data for cost of operations. Care should be exercised to insure that appropriate costs and revenues have been considered, that sufficient capacity and resources would be available to produce the prospective revenues, that capital expenditures have been recognized as appropriate, that provision has been made for applicable taxes, and that the need for financing has been considered.

.05 Support for assumptions might include market surveys, general economic indications, trends, and patterns developed from the entity's operating history, such as historical sales trends, and internal data and analyses such as obligations under union contracts for labor rates.

.06 In analyzing alternative assumptions, care should be exercised to assess the situation objectively. Relating assumptions to past or present conditions often is a useful approach to check for reasonableness or appropriateness; however, trends are not necessarily reliable indicators of the future. Particular attention should be given to the possibility of changes in conditions and those must rest mainly on theory and on understanding of the basic causal factors.

.07 It is ordinarily not feasible to exhaustively document and support all the assumptions underlying financial forecasts. It is nevertheless necessary to seek out and explicitly identify information that forms a basis for the most significant assumptions, although frequently the most basic assumptions with enormous potential impact, such as those relating to war or peace conditions, are not addressed explicitly. Despite precautions, hindsight will often reveal assumptions that have been overlooked or that, in the light of later circumstances, received inadequate treatment. Furthermore, the nature of developing financial forecasts is such that some assumptions will not materialize and unanticipated events and circumstances may occur no matter what effort, analysis, or support may be applied.

317. The process used to develop financial forecasts should provide the means to determine the relative effect of variations in the major underlying assumptions.

.01 Prospective financial results are relatively more sensitive to certain assumptions and less sensitive to others. Small changes in certain assumed conditions can result in relatively large variations in the prospective results, while relatively large changes in other assumptions cause only minor shifts in the prospective results.

.02 In developing financial forecasts, an understanding of the relative sensitivity of the results to the assumed conditions permits the allocation of analysis and study, as well as review by persons of higher authority, to those areas with the most significant effect. Particular attention should be devoted to those assumptions (1) to which the attainment of prospective results is particularly sensitive (i.e., those in which a small variation in the assumption would have a large effect on prospective results), and (2) for which the probability of variation is high.

318. The process used to develop financial forecasts should provide adequate documentation of both the financial forecasts and the process used to develop the forecasts.

.01 Documentation makes possible review and approval of financial forecasts by the responsible party. It facilitates comparison of the financial forecasts with actual financial results, and it provides the discipline necessary for developing reliable financial forecasts. Documentation enables the responsible party to analyze the key factors on which its assumptions were based, thereby allowing for identification of changes in these factors and their anticipated effects on a timely basis.

.02 Documentation involves recording the underlying assumptions as well as summarizing the supporting evidence for the assumptions. Documentation provides the ability to trace prospective financial results back to the support for the basic underlying assumptions.

.03 Adequate documentation makes it possible for persons experienced and qualified in developing financial forecasts to reconstruct the financial forecasts. Documentation covers the process, as well as individual financial forecasts, and provides an organized record of both that can be maintained and made available for subsequent use.

319. The process used to develop financial forecasts should include, where appropriate, the regular comparison of the financial forecasts with attained results.

.01 The objective of financial forecasts is to estimate financial results for one or more future periods, under assumed conditions. Comparison of prospective financial results with actual results for the prospective period and for prior periods for which financial forecasts were prepared provides a historical measure of success in developing financial forecasts and may also be useful as an indication of the likely reliability of future financial forecasts. Regular comparison with actual results and analysis of deviations also provide a basis for making improvements in the methods and approaches used in developing financial forecasts; however, if there is no intention to prepare financial forecasts in the future, there may be no need for such comparisons and analyses.

.02 If prospective results are compared to actual results, the comparison should not be limited to overall financial results but should also include comparison of the key factors and assumptions, such as sales volumes, prices and production rates.

320. The process used to prepare financial forecasts should include adequate review and approval by the responsible party at the appropriate levels of authority.

.01 Financial forecasts are an important statement of the future financial results of an entity. The ultimate responsibility for financial forecasts rests with the responsible party at the highest level of authority, the same level as for historical financial statements.

.02 Adequate review means that the review is conducted in sufficient depth to assure the responsible party of the soundness of the process used to develop the financial forecasts and that the financial forecasts and subsequent revisions were prepared in accordance with the guidelines for the preparation of financial forecasts. The responsible party should have access to the financial forecasts and supporting documentation to adequately review and approve the financial forecasts.

.03 Review by the responsible party at intermediate levels of authority, including such functions as marketing, operations engineering, and finance, enables the financial forecasts to be evaluated from several vantage points by those who will be responsible for the subsequent operations.

Section 400 Presentation of Financial Forecasts

Introduction
.01 This section provides presentation guidelines for entities that choose to issue financial forecasts. The presentation of financial forecasts in conformity with these guidelines, just as for the presentation of historical financial statements, is the responsibility of the responsible party. The responsible party may enlist the assistance of outside parties to meet these presentation standards.

Titles
* .02 The titles used for financial forecasts should describe the nature of the presentation and should include the word "forecast" or "forecasted."

Format
.03 Prospective information presented in the format of historical financial statements facilitates comparisons with financial position, results of operations and changes in financial position of prior periods as well as those actually achieved for the prospective period. Accordingly, financial forecasts preferably should be in the format of the historical financial statements that would be issued for the period(s) covered if there is no agreement between the responsible party and potential users specifying another format. Financial forecasts may take the form of complete basic financial statements[1/] or may be limited to the following minimum items (where such items would be presented for historical financial statements for the period):[2/]

(a) Sales or gross revenues.

(b) Gross profit.

(c) Unusual or infrequently occurring items.

(d) Provision for income taxes.

(e) Discontinued operations or extraordinary items.

(f) Net income.

(g) Primary and fully diluted earnings per share.

1/ The details of each statement may be summarized or condensed, so that only the major items in each are presented. The usual footnotes associated with historical financial statements need not be included as such. However, significant assumptions and accounting policies should be disclosed.

2/ Similar types of financial information should be presented for entities for which these terms do not describe operations.

(h) Significant changes in financial position.3/

(i) Summary of significant assumptions.

(j) Summary of significant accounting policies.

.04 If the items in (a) through (h) above that are applicable to an entity are presented, or are derivable from the information disclosed, then the summaries of significant assumptions and significant accounting policies should be disclosed.4/

.05 The guidelines for preparation of financial forecasts (section 300) apply even if the presentation is limited to the minimum items, above. Therefore, the underlying data used in the preparation of financial forecasts should be sufficient to allow presentation of detailed5/ statements even though only the minimum is to be presented.

.06 Each page of a financial forecast should contain a statement that directs the reader to the summaries of significant assumptions and accounting policies.

Date

.07 The date of preparation of a financial forecast should be disclosed. Such a disclosure assists users in determining how current the presentation is and serves as a warning where such statements were prepared some time ago. The example introduction to the summary of significant assumptions (section 400.24) illustrates such a disclosure.

Accounting Principles and Policies

.08 A summary of significant accounting policies used in preparing the financial forecast should be disclosed. If a financial forecast is included in a document that contains certain of this information, disclosure can be accomplished by cross-referencing.

* .09 Financial forecasts usually should be prepared on a basis consistent with the accounting principles expected to be used in the historical financial statements covering the prospective period (see section 312).

3/ This item does not require a balance sheet or a statement of changes in financial position. This is a summary of significant changes in financial position. Section 410, examples 2 and 3, illustrate such summaries.

4/ A presentation that omits one or more of the applicable minimum items (a) through (h) above is a partial presentation, which would not be appropriate for general offerings of debt or equity. See section 2000 for a discussion of partial presentations.

5/ This level of detail should be comparable to that presented in historical financial statements.

.10 When the historical financial statements for the prospective period are expected to be prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles, the financial forecast preferably should be prepared on that basis of accounting, and the specific information required to be presented should be adapted as appropriate for the basis of accounting used. The basis of accounting used should be disclosed along with the fact that the disclosed basis is different from generally accepted accounting principles.

.11 Occasionally, a different basis of accounting is used for a financial forecast than is to be used for the historical financial statements for the prospective period. That information should be disclosed and differences in results of operations and changes in financial position resulting from the use of a different basis should be reconciled. The example financial projection in section 1410 illustrates such a reconciliation in the case of a cash-basis projection where the historical financial statements are expected to be prepared in conformity with generally accepted accounting principles.6/

.12 If a financial forecast gives effect to a change in accounting principles from one used in prior period historical financial statements, the change should be reported in the financial forecast for the period in which it is expected to be made as would be required in reporting such an accounting change in historical financial statements.7/

Materiality

.13 The concept of materiality applies to financial forecasts as it does to historical financial statements. Accordingly, the provisions of this section need not be applied to immaterial items.

Presentation of Amounts

* .14 Financial forecasts should be expressed in specific monetary amounts. The tentative nature of financial forecasts expressed in single amounts would be emphasized if the amounts representing the key measures (e.g., sales and net income) were supplemented by ranges.

.15 Financial forecasts may be supplemented by financial projections to indicate differences in results of operations and financial position resulting from assumptions other than those expected to materialize (e.g., different levels of sales volume or occupancy rates). If financial forecasts and projections are presented together, each should be clearly labeled. If the alternative presentations are presented side-by-side, there should be a clear indication that the assumptions underlying the presentation at each end of the range, as well as the presentation themselves, do not necessarily represent the best or worst possible alternatives.

6/ Although the example shown is a financial projection, the reconciliation in that example would be applicable to a financial forecast.

7/ See APB Opinion No. 20, Accounting Changes, for guidance as to accounting for and disclosing changes in accounting principles. (see section 312.03).

Assumptions

.16 The disclosure of significant assumptions is integral to the reader's understanding of the financial forecast, accordingly, the responsible party should disclose those assumptions deemed to be most significant to the statements. The disclosure of these assumptions, as well as the basis or rationale for the assumptions and the sources of information used in their development, which ordinarily should also be disclosed, affords the user of the prospective financial statements an opportunity to understand the presentation and make an informed judgment about them. In disclosing the significant assumptions, the responsible party should follow the guidance in sections 400.17-.25.

* .17 Identifying those assumptions which, at the time of preparation, appear to be most significant to the financial forecast requires the careful exercise of good-faith judgment by the responsible party. The assumptions disclosed should include the following:

a. Assumptions as to which there is a reasonable possibility of the occurrence of a variation that may significantly affect the prospective results (sections 400.18-19).

b. Assumptions about anticipated conditions that are expected to be significantly different from current conditions, which are not otherwise reasonably apparent (section 400.20).

c. Other matters deemed important to the prospective information or its interpretation (section 400.21).

.18 The presentation should indicate which assumptions disclosed appeared particularly sensitive at the time of preparation. Although the responsible party should try to identify sensitive assumptions, hindsight may reveal sensitive assumptions that did not appear so earlier (see sections 313.03 and 317.02).

.19 Sensitive assumptions are those assumptions for which a variation would materially affect the financial forecast. The impact on the financial forecast might result from either (a) an assumption with a relatively high probability of a sizable variation, or (b) an assumption for which the probability of a sizable variation is not as high but for which a small variation would have a large impact. Not all significant assumptions are sensitive. For example, an assumption regarding the federal income tax rate may be significant but not sensitive while the assumption about the interest rate of a new debt issue may be both significant and sensitive. The disclosure of sensitive assumptions need not include a quantification of the potential effects of variations in those assumptions. The illustrative prospective financial statements in section 410 include examples of disclosures of assumptions that are particularly sensitive.

.20 Frequently, a basic assumption is made that current conditions having enormous potential impact will continue to prevail and is considered to be implicit in the financial forecast. Examples are conditions of peace, absence of natural disasters, etc. Such assumptions need be disclosed only when there is a reasonable possibility that the current conditions will not prevail.

.21 The following are other factors with respect to the disclosure of assumptions that should be considered:

(a) By nature, financial forecasts embody a large number of assumptions, especially for a complex enterprise. An attempt to communicate all assumptions is inherently not feasible.

(b) Outside users who disagree with one or more assumptions in financial forecasts are generally not able to adjust for the effect of these differences in assumptions.

(c) Questions may arise after the fact as to certain assumptions that were not disclosed. Unforeseen changes in conditions may make certain assumptions, previously considered unimportant, significant.

.22 Although all significant assumptions should be disclosed, they need not be presented in such a manner or in such detail as would adversely affect the competitive position of the entity.

.23 It should be made clear that the assumptions disclosed are not an all-inclusive list of those used in the preparation of the prospective information and that they were based on information about circumstances and conditions existing at the time the prospective information was prepared. Accordingly, this fact, as well as a description of the nature of the assumptions, should be provided in an introduction preceding the summary of assumptions.

* .24 The introduction for a financial forecast should be similar to the following:

> This financial forecast presents, to the best of management's[8/] knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the forecast reflects its judgment, based on present circumstances, of the expected set of conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to (date), the date of this forecast. Therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

.25 Examples of disclosures of assumptions appear in the illustrative financial forecasts in section 410.

Period to be Covered

.26 The responsible party should consider the needs of the user and its ability to estimate prospective results in determining the period to be covered. Ordinarily, to be meaningful to users the presentation should include at least one full year of normal operations. For example, to meet user needs an entity forecasting a major acquisition would present at least the first full year following the acquisition; a newly-formed entity would include at least the first full year of normal operations; and an entity that annually prepares forecasts would present a forecast covering at least a full year. However, no fixed period of time is specified in this guide.

8/ If the responsible party is other than management, this reference should be to that third party who assumes responsibility for the assumptions.

.27 Although the degree of uncertainty generally increases with the time span, short-term financial forecasts may not be meaningful in (a) industries with a lengthy operating cycle or (b) situations where long-term results are necessary to evaluate the investment consequences involved. It may not be practical in all situations to present financial forecasts for enough future periods to demonstrate the long term results. In those circumstances, the presentation should include a description of the effects of such results. For example, if the presentation does not extend to the period in which significant prospective tax benefits begin to reverse, the disclosures would include a discussion of the effects of the reversal. Example 3 in section 410 illustrates such a disclosure.

.28 To meet user needs, the responsible party may present prospective financial statements for periods that extend beyond its ability to effectively forecast. In these cases the responsible party may not be able to make single point estimates of the expected financial position, results of operations, and changes in financial position for the later prospective periods. Accordingly, these presentations may consist of forecasts for a number of earlier periods and multiple projections for later periods, although the responsible party may find it difficult to determine precisely at what point it can no longer forecast. When both types of prospective financial statements are presented, each should be clearly identified.

Distinguishing From Historical Financial Statements

.29 Financial forecasts should be clearly labeled to preclude a reader from confusing them with historical financial statements.

.30 Prior period information, such as historical results, and financial forecasts for prior periods may be presented alongside financial forecasts to facilitate comparison. When such prior period information is presented, it should be clearly labeled and distinguished from the financial forecasts.

Correction and Updating of a Financial Forecast

.31 Correction of a financial forecast refers to modification of the forecast after issuance for an error that was made in preparing the forecast. Updating a financial forecast refers to changing the forecast to reflect changes in assumptions, actual results, or unanticipated events or circumstances.[9]

.32 Correction. Where the responsible party discovers that an error was made in preparing a financial forecast, it should determine if any users are currently relying or are likely to rely on the forecast. The responsible party should inform any such users that the forecast is no longer to be relied upon and, where practical, issue a corrected forecast.

.33 Updating. Updated financial forecasts should be issued in appropriate circumstances unless (a) the original forecast included a statement that it was not intended to be updated (see section 400.36) or (b) issuance of historical financial statements covering the prospective period is imminent. In deciding whether it would be appropriate to issue an updated financial forecast, the responsible party should consider whether users would expect prospective statements to be updated (for example, users might expect updated statements from an SEC registrant that regularly issues financial forecasts). The reasons for updating should be described in a note to the updated presentation.

9/ Thus, updating requires reanalysis of key factors and assumptions and preparation of a new financial forecast.

.34 When a potential material change in a financial forecast exists but cannot be quantified so as to permit issuance of an updated forecast promptly, appropriate disclosure should be made. Such disclosure would include a description of the circumstances necessitating an updated financial forecast and notification that the prospective information should not be used for any purpose and that an updated financial forecast will be issued upon its completion.

.35 If, however, the responsible party decides that the current financial forecast should no longer be used for any purpose but it is not appropriate to issue an updated forecast, this decision and the reason for it should be disclosed to persons who are currently relying or who are likely to rely on the forecast.

.36 Financial Forecasts Not Intended to be Updated. Financial forecasts frequently are issued on a "one-time" basis, such as in connection with an offering for debt or equity financing, without any intention to issue updated financial forecasts. In such cases, emphasis should be given to the date of issuance of the prospective information. In addition, the responsible party's intention not to update the prospective information should be specifically disclosed.

.37 When the responsible party has reason to believe that outside parties are currently relying or are likely to rely on financial forecasts that are no longer reliable, and there is no intention to issue updated statements, the responsible party should consider whether it has an obligation to take further action even though the forecasts contained an explicit statement that they would not be updated.

.38 An example of an explicit statement regarding a financial forecast not intended to be updated to be included in the summary of significant assumptions would be:

> The following financial forecast was prepared as of March 30, 19XX to assist the prospective bondholders in estimating whether the operations of the XYZ Company may be expected to support a $10,000,000 bond issue. Because it is contemplated that the entire bond issue will be sold within 90 days hereafter, management does not intend to revise this forecast to reflect changes in present circumstances or the occurence of unanticipated events.

Section 410 Illustrative Financial Forecasts

.01 This section includes the following illustrative financial forecasts presented in conformity with the presentation guidelines in section 400:

- Examples 1 and 2 in this section are financial forecasts for a manufacturing or commercial type entity. Although the preferable presentation of prospective financial statements ordinarily consists of a complete set of statements (similar to the entity's historical financial statements) as shown in Example 1, a presentation may be limited to the applicable minimum items described in section 400.03 as shown in Example 2.

- Example 3 illustrates a financial forecast presented on a tax basis of accounting typically used in limited partnership ventures. Such ventures do not normally prepare financial statements on other than a tax basis, therefore the minimum presentation items in section 400.03 should be adapted to fit a tax presentation.

.02 Section 400.03 indicates that the minimum disclosure items need be presented only when applicable but should be adapted as necessary to portray operations. Example 3 illustrates how the minimum items might be adapted in the case of an entity in the business of renting property. The example meets the minimum presentation guidelines as follows:

	Minimum Disclosure Item	Example 3 Presentation
a.	Sales or gross revenues	Rental income
b.	Gross profit	Not applicable
c.	Provision for income taxes	Not applicable
d.	Net income	Taxable income (loss)
e.	Disposal of a segment	Not applicable
f.	Earnings per share	Share of taxable income (loss) per unit.
g.	Significant anticipated changes in financial position	o Investment by limited partners o Financing o Construction expenditures o Repayments of principal o Cash distributions
h.	Summary of significant assumptions	Summary of significant forecast assumptions
i.	Summary of significant accounting policies	(not illustrated)

.03 The example includes disclosure of the potential tax consequences if the property were to be sold at the end of the forecast period as an aid to users in evaluating long term investment consequences, since the forecast does not extend to the period in which the property is expected to be sold.

.04 The illustrations presented are consistent with the guidance in section 400 although other presentation formats could also be consistent. For example, although all of the examples present the summary of significant assumptions and accounting policies after the presentation of prospective amounts, in some cases it may be appropriate to present them first. In other cases, it may be appropriate to commingle the disclosures of assumptions and accounting policies rather than presenting them separately. The appropriateness of any format depends upon individual circumstances.

Example 1

XYZ Company, Inc.

Forecasted Statement of Income and Retained Earnings

Year Ending December 31, 19X3
(in thousands except per share amounts)

	Forecasted	Comparative historical information	
	19X3	19X2	19X1
Net Sales	$101,200	$ 91,449	$ 79,871
Cost of Sales	77,500	70,140	60,463
Gross Profit	23,700	21,309	19,408
Selling, general, and administrative expenses	15,100	13,143	11,014
Operating Income	8,600	8,166	8,394
Other income (deductions):			
Miscellaneous	1,700	964	(308)
Interest expense	(2,400)	(1,914)	(1,943)
	(700)	(950)	(2,251)
Income before income taxes	7,900	7,216	6,143
Income taxes	3,400	3,267	2,929
Net income for the year	4,500	3,949	3,214
Retained earnings at beginning of year	10,500	7,803	5,543
Dividend (per share 19X3: $1.50; 19X2: $1.35; 19X1: $1.00)	(1,400)	(1,288)	(954)
Retained earnings at end of year	$ 13,600	$ 10,464	$ 7,803
Earnings per share	$ 4.73	$ 4.14	$ 3.37

See accompanying Summary of Significant Forecast Assumptions and Accounting Policies.

Example 1

XYZ Company, Inc.

Forecasted Statement of Changes in Financial Position

Year Ending December 31, 19X3
(in thousands)

	Forecasted 19X3	Comparative historical information 19X2	Comparative historical information 19X1
Sources of cash			
Net income	$ 4,500	$ 3,949	$ 3,214
Depreciation, which does not use cash	2,800	2,422	2,181
Cash provided by operations	7,300	6,371	5,395
Increase (decrease) in:			
Notes payable to bank	1,500	100	(300)
Accounts payable and accrued expenses	1,100	1,696	846
Current installments of long-term debt	400	958	342
Other current liabilities	-	811	161
Proceeds from long-term borrowings	6,000	4,100	2,000
	16,300	14,036	8,444
Uses of cash			
Dividend	1,400	1,288	954
Current installments and repayment of long-term debt	2,600	3,800	2,300
Additions to plant and equipment	4,400	2,907	2,114
Increase in other assets	2,200	600	83
Increase in:			
Accounts receivable	2,500	1,430	483
Inventory	100	3,995	1,431
Other current assets	1,700	350	62
	14,900	14,370	7,427
Increase (decrease) in cash	1,400	(334)	1,017
Cash beginning of year	1,900	2,196	1.179
Cash end of year	$ 3,300	$ 1,862	$ 2,196

See accompanying Summary of Significant Forecast Assumptions and Accounting Policies

Example 1

XYZ Company, Inc.

Forecasted Balance Sheet

December 31, 19X3
(in thousands)

	Forecasted	Comparative historical information	
	19X3	19X2	19X1
Assets			
Current assets			
Cash	$ 3,300	$ 1,862	$ 2,196
Accounts receivable (net)	14,900	12,438	11,008
Inventory	27,000	26,932	22,937
Other	3,500	1,813	1,463
Total current assets	48,700	43,045	37,604
Property, plant, and equipment	30,900	26,915	22,832
Less accumulated depreciation	17,300	14,912	11,314
Net property, plant, and equipment	13,600	12,003	11,518
Other assets	5,000	2,714	2,114
	$ 67,300	$ 57,762	$51,236
Liabilities and Stockholders' Equity			
Current liabilities			
Notes payable to bank	$ 4,600	$ 3,100	$ 3,000
Accounts payable and accrued expenses	12,300	11,193	9,497
Current installments of long-term debt	4,400	3,968	3,010
Other	900	925	114
Total current liabilities	22,200	19,186	15,621
Long-term debt, excluding current installments	20,100	16,700	16,400
Stockholders' equity			
Capital stock	11,400	11,412	11,412
Retained earnings	13,600	10,464	7,803
Total stockholders' equity	25,000	21,876	19,215
	$ 67,300	$ 57,762	$51,236

See accompanying Summary of Significant Forecast Assumptions and Accounting Policies.

Example 1 presents one format for prospective financial statements. However, a more summarized presentation may be given (see section 400.07). Following is a summarized presentation that could be used in lieu of the preceding example.

Example 2

XYZ Company, Inc.

Summarized Financial Forecast

Year Ending December 31, 19X3
(in thousands except per share accounts)

	Forecasted 19X3	Comparative historical information* 19X2	19X1
Sales	$ 101,200	$ 91,449	$79,871
Gross profit	23,700	21,309	19,408
Income tax expense	3,400	3,267	2,929
Net income	4,500	3,949	3,214
Earnings per share (in dollars)	4.80	4.14	3.37
Significant anticipated changes in financial position:			
Cash provided by operations	7,300	6,371	5,395
Net increase (decrease) in long-term borrowings	3,400	300	(300)
Dividend payment (per share 19X3: $1.50; 19X2: $1.35; 19X1: $1.00)	1,400	1,288	954
Additions to plant and equipment	4,400	2,907	2,114
Increase (decrease) in cash	1,400	(334)	1,017

See accompanying Summary of Significant Forecast Assumptions and Accounting Policies.

* Comparative historical information is not part of the minimum presentation described in section 400.07.

Examples 1 and 2
XYZ Company, Inc.
Summary of Significant Forecast Assumptions
and Accounting Policies
for the Year Ending December 31, 19X3

This financial forecast presents, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period.[1] Accordingly, the forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. Some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur subsequent to February 17, 19X3, the date of this forecast. Therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material. The comparative historical information for 19X1 and 19X2 is extracted from the Company's financial statements for those years. Those financial statements should be read for additional information.

a. **Summary of Significant Accounting Policies.** (not illustrated)

b. **Sales.** The overall market for the Company's products has grown over the past five years at an average rate of 2 percent above the actual increase in gross national product, and the Company's market share has remained steady at 14 to 16 percent. Based on a recent market study of demand for the Company's products, sales are forecasted to increase 11 percent from 19X2 (which is 2 percent above the Department of Commerce Bureau of Economic Analysis estimate of the rise in gross national product in the forecast period), with a market share of 15 percent and unit prices increased to cover a significant portion of forecasted increased cost of manufacturing.

c. **Cost of Sales**

Materials. Materials used by the Company are expected to be readily available, and the Company has generally used producer associations' estimates of prices in the forecast period to forecast material costs. The price for copper, a major raw material in the Company's products, recently has been disrupted by political events in certain principal producer countries. As a result, industry estimates of copper prices in the forecast period range from 15 to 30 percent above 19X2 prices. The Company expects to be able to assure sufficient supplies and estimates that the cost of copper will increase by 22 percent over 19X2. However, due to the uncertainties noted above, the realization of the forecast is particularly sensitive to the actual price increase. A variation of five percentage points in the actual increase above or below the assumed increase would affect forecasted net earnings by approximately $485,000.

Labor. The Company's labor union contract, which covers substantially all manufacturing personnel, was negotiated in 19X2 for a three-year period. Labor costs are forecasted based upon the terms of that contract.

1/ For the presentation illustrated in Example 2, this would read "...a summary of the Company's expected results of operations and changes in financial position..."

d. **Plant and Equipment and Depreciation Expense.** Forecasted additions to plant and equipment, $4.4 million, comprise principally the regular periodic replacement of manufacturing plant and vehicles at suppliers' quoted estimated prices and do not involve any significant change in manufacturing capacity or processes. Depreciation is forecasted on a item-by-item basis.

e. **Selling, General, and Administrative Expenses.** The principal types of expense within this category are salaries, transportation costs, and sales promotion. Salaries are forecasted on an individual-by-individual basis, using expected salary rates in the forecast period. Pension cost is forecasted based upon its direct relationship to payroll cost. Transportation costs comprise principally the use of contract carriers; volume is forecasted based upon the sales and inventory forecasts (including forecasts by sales outlet), and rates are forecasted to rise by 16 percent over 19X2, based upon trucking industry forecasts. Sales promotion costs are expected to increase by approximately 14 percent above the level of 19X2 in order to meet increased competition and maintain market share. The level of other expenses is expected to remain the same as in 19X2, adjusted for expected increases in line with the consumer price index (assumed to rise 9 percent based on the mean of (several widely used estimates)).

f. **Miscellaneous Income.** The forecast assumes royalty income of $950,000 will be received based on an agreement under which the Company is to receive a minimum of $950,000 for the first 10,000,000 units produced under its patented die casting process and $.05/unit above that level. Management believes it is unlikely that production will exceed 10,000,000 units. The balance of miscellaneous income is assumed to come from investment of excess cash and other sources.

g. **Bank Borrowings and Interest Expense.** The forecast assumes that the Company will obtain an extension of existing short-term lines of credit at terms comparable to those in effect in 19X2 (2 percent over prime rate). The Company used the arithmetic mean of (three widely used estimates) of bank prime rate during the forecast period (ranging from 12 percent to 14 percent) to estimate prime rate at 13 percent. However, because of recent volatility in the financial markets, short-term interest rates have been very unstable, ranging from 12 percent to 17 percent during 19X2.

The Company has forecasted additional long-term borrowings of $6 million and has entered into preliminary negotiations with its bankers for this financing. The borrowings are principally to fund purchases of plant and equipment and additions to other long-term assets and will be secured by such additions. Based upon the preliminary negotiations, the company has assumed that the additional long-term financing will bear interest at 14 percent.

h. **Income Taxes.** The provision for income taxes is computed using the statutory rates in effect during 19X2, which are not expected to change, and assuming investment tax credit on qualifying investments at rates in effect in 19X2.

i. **Dividend.** The Company's normal dividend policy is to pay out the previous year's dividend increased to the extent of at least one-third of any increase in profits over the previous year, provided the board of directors considers that the Company's cash and working capital position will not be adversely affected. The dividend has been forecasted at $1.50 per share, assuming an increased payout over 19X2 of one-third of the excess of forecasted net earnings for the year ending December 31, 19X3, above those of 19X2.

Example 3
DEF Associates, Ltd.
(A Limited Partnership)
Statement of Forecasted Taxable Income

Seven Years Ending December 31, 19X8

	Years Ending December 31,						
	19X2	19X3	19X4	19X5	19X6	19X7	19X8
Rental Income	-	$ 349,200	404,820	432,900	463,320	496,080	530,400
Expenses:							
Amortization of construction period expenses	$ 54,900	29,865	22,865	22,865	22,865	22,865	22,865
Operating expenses	-	122,220	141,187	151,515	162,163	173,628	185,640
Mortgage Interest	-	172,003	185,500	183,000	180,000	176,800	173,300
Depreciation	-	110,600	120,667	120,667	120,667	120,667	120,677
Total Expenses	54,900	434,688	470,219	478,047	485,695	493,960	502,482
Taxable (loss) income for year	(54,900)	(85,488)	(65,399)	(45,147)	(22,375)	2,120	27,918
Applicable sharing ratio of Limited Partners	.95	.95	.95	.95	.95	.95	.95
Limited Partner's Share of Taxable Income (Loss)	$ (52,155)	(81,213)	(62,129)	(42,890)	(21,256)	2,014	26,522
Cumulative	$ (52,155)	(133,368)	(195,497)	(238,387)	(259,643)	(257,629)	(231,107)

See Accompanying Summary of Significant Forecast Assumptions and Accounting Policies

Example 3
DEF Associates, Ltd.
(A Limited Partnership)
Statement of Forecasted Sources and Uses of Cash

Seven Years Ending December 31, 19X8

	Years Ending December 31,						
	19X2	19X3	19X4	19X5	19X6	19X7	19X8
Sources of Cash:							
Investment by Limited Partners	$ 500,000	-	-	-	-	-	-
Outside Financing	1,421,000	129,000	-	-	-	-	-
	1,921,000	129,000	-	-	-	-	-
Cash From Operations:							
Taxable Income (Loss)	(54,900)	(85,488)	(65,399)	(45,147)	(22,375)	2,120	27,918
Add (Deduct): Depreciation and Amortization	-	110,600	120,667	120,667	120,667	120,667	120,667
Deferred construction period expenses	(189,900)	5,215	22,865	22,865	22,865	22,865	22,865
Cash From Operations	(244,800)	30,327	78,133	98,385	121,157	145,652	171,450
Total Sources	1,676,200	159,327	78,133	98,385	121,157	145,653	171,450
Uses of Cash:							
Organization Costs	6,500	-	-	-	-	-	-
Construction Costs & Furnishings	1,650,000	160,000	-	-	-	-	-
Repayment of Mortgage Principal	-	14,862	18,355	20,888	23,771	27,055	30,588
Distributions to Limited Partners	-	-	55,000	75,000	100,000	98,100	91,000
Distributions to General Partners	-	-	-	-	-	16,900	49,000
Total Uses	1,656,500	174,862	73,355	95,888	123,771	142,055	170,588
Change in Cash	19,700	(15,535)	4,778	2,497	(2,614)	3,597	862
Cash balance beginning of year	-	19,700	4,165	8,943	11,440	8,826	12,423
Cash balance end of year	$ 19,700	4,165	8,943	11,440	8,826	12,423	13,285

See Accompanying Summary of Significant Forecast Assumptions and Accounting Policies

Example 3
DEF Associates, Ltd.
(A Limited Partnership)
Forecasted Statement of Allocation of Limited Partner Interest Per $5000 Unit

Seven Years Ending December 31, 19X8

	Years Ending December 31,						
	19X2	19X3	19X4	19X5	19X6	19X7	19X8
Limited Partner Investment per Unit	$ 5,000	$ -	$ -	$ -	$ -	$ -	-
Share of Taxable Loss (Income)	$ 522	$ 812	$ 621	$ 429	$ 213	$ (20)	(265)
Assumed Tax Bracket	50%	50%	50%	50%	50%	50%	50%
Tax Benefit (Expense)	261	406	311	215	106	(10)	(133)
Cash Distributions	-	-	550	750	1,000	981	910
Total Tax Benefits and Cash Distributions	$ 261	$ 406	$ 861	$ 965	$ 1,106	$ 971	777
Cumulative: Cash Flow	$ (4,739)	$ (4,333)	$ (3,472)	$ (2,507)	$ (1,401)	$ (431)	347
Taxable Income (Loss)	$ (522)	$ (1,334)	$ (1,955)	$ (2,384)	$ (2,597)	$ (2,576)	(2,311)

See Accompanying Summary of Significant Forecast Assumptions and Accounting Policies

Example 3
DEF Associates, Ltd.
Summary of Significant Forecast Assumptions and Accounting Policies

For the Seven Years Ending December 31, 19X8

This financial forecast presents, to the best of management's knowledge, a summary of the Company's expected results of operations, changes in financial position, and cash flow for the forecast period presented on the tax basis of accounting. Accordingly, the forecast reflects its judgment, based on present circumstances, of the expected set of conditions and its expected course of action. The assumptions disclosed herein are those that management believes are significant to the forecast. Some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur subsequent to March 30, 19X1, the date of this forecast. Therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

The body of tax law is in a continuous state of flux. Accordingly, there could be developments, statutory or otherwise, that would alter the forecast. Because transactions are susceptible to varying interpretations under income tax law rulings and regulations, the Internal Revenue Service may not concur with the determinations of the factual issues and the interpretations of existing law, rulings and regulations that management used as the basis for the assumptions used to prepare the forecast. Non-concurrence might alter the forecast.

a. **Summary of Significant Accounting Policies.** (not illustrated)
b. **Description of the Project.** The proposed development, DEF Gardens, is a 70 unit apartment complex to be constructed on an 8.25 acre, residentially zoned property in Phoenix, Arizona. Construction of the development is anticipated to begin on July 15, 19X1 and be completed by August 1, 19X2 (see note e). Equity financing is proposed to be obtained from the sale of 100 limited partnership units at $5,000 per unit. The proceeds from the sale together with anticipated bank financing are expected to provide the necessary funding requirements for the project (see note h).
c. **Allocation of Income, Losses and Cash Distributions.** The Partnership Agreement provides that the limited partners (as a group) are to (a) share in 95% of the partnerships net income or loss (.95% of such net income or loss being attributable to each $5,000 partnership unit), and (b) receive 100% of all cash distributions from operations (1% to each partnership unit) until such time as the limited partners capital accounts become equal to zero. Thereafter, all distributions are to be allocated 65% to the limited partners (as a group) and 35% to the general partner, including distributions, if any, on the sale or disposition of the partnership properties. Cash available for distribution will only be limited to the extent necessary to meet normal operating needs. The initial cash distribution is forecasted to occur in 19X4 and annually thereafter.

   Income or losses of the partnership for a year are allocable to the partners pro-rata for the portions of the year in which the respective partners were members of the partnership. The forecast of the allocation of the net loss to be sustained for the year 19X2 is based on the assumption that all limited partners will acquire their interests in the partnership as of July 1, 19X1.

d. **Rental Income.** Rental income, consisting of apartment rentals, is based upon the General Partner's estimates that the apartment building will be available for occupancy on or before August 1, 19X2, and the number of units occupied, average rent per unit and percentage occupancy will be as follows:

	19X3	19X4	19X5	19X6	19X7	19X8
Number of units occupied	60	65	65	65	65	65
Average monthly rental per unit	\$ 485	\$ 519	\$ 555	\$ 594	\$ 636	\$ 68[illegible]
Percentage occupancy	86%	93%	93%	93%	93%	9[illegible]

The average monthly rental per unit is forecasted to increase 7 percent per year from 19X3 through 19X8 based upon the most recent experience in the area. Occupancy percentage is based upon the General Partner's study of demand for the forecast period and is consistent with percentages currently obtained on similar apartment complexes managed by the General Partner. For each 30 day period subsequent to August 2, 19X2 that occupancy is delayed, if any, rental income for 19X3 will be reduced by approximately \$29,000.

e. **Construction Period Expenses.** Expenses expected to be incurred during the construction period (July 15, 19X1 to August 1 19X2) consist of the following:

	19X1	19X2
Interest on Construction Loan	\$ 203,000	\$ 16,900
Real Estate Taxes	8,000	750
Insurance	10,000	1,000
Legal and Accounting	6,000	500
Management Fees, Rental and Advertising Expenses	11,500	3,400
Other	6,300	2,100
	\$ 244,800	\$ 24,650

Such expenses are based upon the General Partner's most recent experience in similar apartment complexes in the area. Interest on the construction loan and real estate taxes incurred during the construction period will be amortized on a straight line basis over 10 years, in accordance with IRS guidelines. For each 30 day period subsequent to August 2, 19X2 that the construction continues, construction period expenses for 19X3 (primarily interest) will increase by approximately \$25,000.

f. **Operating Expenses.** Annual expenses for the operation of the partnership's property are forecasted to be 35 percent of rental income consistent with the General Partner's experience on similar apartment complexes. Operating expenses include salaries for the apartment manager, repairs and maintenance, insurance, real estate taxes, and utilities. They also include a management fee of $10,000 per year to the General Partner and lease payments to the General Partner of $4,630 per month for the use of the land on which the apartment complex is to be constructed. The initial fixed term of the lease is for 25 years with an option to renew for an additional 25 years.

g. **Depreciation.** The estimated construction costs, depreciable lives and depreciation per year have been determined by the General Partner. Depreciation is computed using the straight-line method based on an ACRS (Accelerated Cost Recovery System) useful life of 15 years.

h. **Financing Arrangements.** Construction of the 70 unit apartment project and construction period expenses are to be financed by the limited partners' capital contribution of $500,000 and by a $1,550,000 construction loan. It is anticipated that the loan will bear interest at the annual rate of 14 percent. Upon completion of construction, a permanent 30 year non-recourse mortgage loan will become effective at an annual rate of 13%, with the first principal payment estimated to commence in August 19X3. For each ¼% variance in the actual interest rates obtained, the dollar amount of interest expense, and the resulting taxable loss will vary by approximately $2,000 in 19X3 and $4,000 in 19X4 through 19X8.

i. **Tax Matters.** The Partnership is relying on an opinion from its legal counsel that it is more likely than not that the investors will prevail on the merits of each material tax issue and that the material tax benefits in the aggregate are likely to be realized.

   State and local income taxes are not provided for in this forecast. Each partner may be liable for state and local income taxes on his portion of the Partnerships profits and should consult his personal tax advisor in this regard.

j. **Analysis of Tax Effect on Sale on Property at End of Forecast Period.** The following table illustrates the effect on Limited Partners' Capital of a sale of the apartment complex at December 31, 19X8 at the prices shown and subsequent liquidation of the partnership. The table is included for analysis purposes only as the General Partner believes that it is improbable that the apartment complex will be sold at the date or for the amounts shown.

	Sale for existing mortgage balance	Sale for 1,914,481(a)
Total proceeds available at sale	$ 1,414,481	$ 1,914,481
Less:		
Mortgage balance	(1,414,481)	(1,414,481)
Proceeds available for distribution	$ -	$ 500,000
Applicable sharing ratio of Limited Partners	65%	65%
Limited Partners' share of proceeds	$ -	$ 325,000
Limited Partners' proceeds per $5,000 unit	$ -	$ 3,250
Limited Partners' share of taxable gain on sale:		
Total proceeds available to Limited Partners	$ -	$ 325,000
Original capital contribution	500,000	500,000
Less:		
Cumulative taxable losses	(231,107)	(231,107)
Cash distributions - other than from sale	(419,000)	(419,000)
Capital account (deficit) at date of sale	(150,107)	(150,107)
Limited Partners' total taxable gain upon sale	$ 150,107	$ 475,107
Limited Partners' taxable gain upon sale - per $5,000 unit	$ 1,501	$ 4,751
Limited Partners' tax on sale per $5,000 unit, assuming a 50% tax bracket(b)	$ 300	$ 950

(a) The sales price illustrated is based on the mortgage balance plus the Limited Partners original capital contribution.

(b) The above illustrations do not reflect the effect of (1) any capital losses in the year the gain is recognized, or (2) the minimum tax, if any since they would be dependent upon each individual partner's tax situation in the year of sale.

GUIDANCE FOR ACCOUNTANTS WHO PROVIDE SERVICES ON FINANCIAL FORECASTS

Section 500 The Accountant's Services With Respect To Financial Forecasts

* .01 An accountant is associated with a financial forecast when he has consented to the use of his name in conjunction with the forecast in a report, document, or written communication containing the forecast. Also, when an accountant submits to his client or others a financial forecast that he has assembled or assisted in assembling, he is deemed to be associated even though the accountant does not append his name to the forecast. The accountant who is associated with a financial forecast should compile or review the forecast and report[1/] accordingly; however, he is not deemed to be associated with a forecast that, prior to the issuance of his report, is clearly identified as a draft.

.02 Management, shareholders, lenders, and others who use financial forecasts should be able to identify readily the degree of responsibility, if any, the accountant is taking with respect to such forecasts. Accordingly, whenever an accountant performs a compilation or review of a financial forecast, he should issue a report in accordance with the applicable guidance set forth in this guide.[2/]

.03 The accountant who compiles, reviews, or audits historical financial statements that are in a client-prepared document containing a financial forecast should not consent to the use of his name in the document unless (a) he has compiled or[3/] reviewed the financial forecast and his report accompanies it, (b) the financial forecast is accompanied by an indication by the responsible party or the accountant that the accountant has not performed such a service on the forecast and that he assumes no responsibility for it or (c) another accountant has performed a service on the forecast and his report is included in the document. In addition, if the accountant has audited the historical financial statements and they accompany a financial forecast on which he has performed no service, in certain[4/] client-prepared documents, he should refer to SAS No. 8, Other Information in Documents Containing Audited Financial Statements.

.04 The accountant who compiles or reviews a financial forecast that is included in a client-prepared document containing historical financial statements should not consent

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1/ Accountant's reports on compilations and reviews are contained in sections 620 and 720, respectively.

2/ This includes association with financial forecasts arising from or relating to accounting, auditing, tax, or management advisory services.

3/ The SEC's current position is that it will not accept compilations of prospective financial statements. Therefore the accountant's report on a compilation of prospective financial statement should not be included in an SEC filing.

4/ SAS No. 8 applies only to such financial forecasts contained in (a) annual reports to holders of securities or beneficial interests, annual reports of organizations for charitable or philanthropic purposes distributed to the public, and annual reports filed with regulatory authorities under the Securities Exchange Act of 1934 or (b) other documents to which the auditor, at the client's request, devotes attention. However, SAS No. 8 does not apply when the historical financial statements and report appear in a registration statement filed under the Securities Act of 1933 (in which case, see SAS No. 37, Filings Under Federal Securities Statutes).

to the use of his name in the document unless (a) he has compiled, reviewed, or audited the historical financial statements and his report accompanies them, or (b) the historical financial statements are accompanied by an indication by the responsible party or the accountant that the accountant has not performed such a service on the historical financial statements and that he assumes no responsibility for them, or (c) another accountant has performed a service on them and his report is included in the document. (Also see section 500.14.)

.05 The summary of significant assumptions is integral to the reader's understanding of financial forecasts. Accordingly, the accountant should not be associated with financial forecasts that exclude disclosure of significant assumptions.

.06 Since an accountant's association with a financial forecast tends to lend credibility to the forecast, he should consider when it is not proper to be associated with such statements. The accountant may deem it inappropriate to be associated with financial forecasts that would be misleading, for example, those with underlying assumptions that are inappropriate.5/

Accountant's Services

.07 The accountant may be engaged to provide services on a financial forecast for a variety of reasons, including assistance to his client regarding financing, business acquisitions, internal planning and tax planning. As part of an engagement to provide services on a financial forecast he may either compile or review them. When the accountant's engagement includes compilation of a financial forecast, he should follow the guidance contained in sections 600-620 of this guide. When his engagement includes review of a financial forecast, he should follow the guidance contained in sections 700-720.6/ Before accepting an engagement including a review of a financial forecast, the accountant should first consider whether the presentation is susceptible to review.

Susceptibility to Review

* .08 A presentation is susceptible to review if there is suitable support for the underlying assumptions. In deciding whether the assumptions are suitably supported to allow a review, the accountant should consider how thoroughly the responsible party has identified key factors, developed assumptions relative to those factors, and considered the multiple impacts of assumptions.7/ In addition, the accountant should consider the adequacy and availability of underlying documentation for the assumptions.

.09 Underlying documentation for assumptions may include market surveys, engineering studies, general economic indications, industry statistics, trends and patterns developed from the entity's operating history, and internal data and analyses, accompanied by supporting logical argument or theory. The rationale for these can range from information based on opinion to data derived from historical sources, such as future commitments on current leases.

5/ When the accountant considers the assumptions to be inappropriate, he should follow the guidance in section 600.10(k) if he was engaged to compile the prospective financial statements or section 720.04 if engaged to review the statements.

6/ The accountant should not characterize his engagement or procedures as a review unless he complies with the guidance in sections 700-720.

7/ The accountant may assist the responsible party in these areas, see section 500.13.

Change in Engagement From Review to Compilation

.10 An accountant whose engagement presumed a review of a financial forecast may, before the completion of his engagement, be requested to change the engagement to a compilation. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for a review, a misunderstanding as to the nature of a review or the alternative compilation services originally available, or a restriction on the scope of the review, whether imposed by the entity or caused by circumstances.

.11 In complying with the request to change the nature of the engagement the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. If the accountant believes that the information so affected is unsatisfactory, he should try to obtain that information and consider whether a change to a compilation service would be inappropriate and whether he should issue an adverse review report or withdraw from the engagement.

.12 If the engagement is changed,[8/] upon completion of the compilation engagement the accountant should issue an appropriate compilation report. The report should not include reference to (a) the original engagement, (b) any review procedures that may have been performed, or (c) scope limitations that resulted in the changed engagement.

Assistance to the Entity

.13 In performing a compilation or review of a financial forecast the accountant may be called upon to assist the responsible party in identifying assumptions, information gathering, or assembly. The responsible party is nonetheless responsible for the preparation and presentation of the financial forecast because only it can take responsibility for the assumptions. Accordingly, the accountant's engagement should not be characterized in his report or in the document containing his report as including preparation of the financial forecast.

Other Information in a Client-Prepared Document Containing a Financial Forecast

.14 An entity may publish various documents that contain information other than historical financial statements in addition to the compiled or reviewed financial forecast and the accountant's report thereon. The accountant's responsibility with respect to information in such a document does not extend beyond the financial information identified in the report and he has no obligation to perform any procedures to corroborate other information contained in the document. However, the accountant should read the other information and consider whether such information, or the manner of its presentation, is materially inconsistent with the information, or manner of its presentation, appearing in the financial forecast.

8/ If the engagement is changed the accountant may deem it appropriate to establish an understanding in writing with the client as to the new service to be performed. Sample engagement letter excerpts for compilation services appear in section 610.

* .15 The following phrases are examples of the types of remarks that would be considered inconsistent information in a document containing a financial forecast (e.g. in a discussion of risk factors or a tax opinion included in the document):

- o ...cannot be predicted at this time...
- o ...unlikely to occur...
- o No prediction can be made ...

.16 If the accountant reviews the financial forecast included in a document containing an inconsistent statement, he might not be able to conclude that there is adequate support for each significant assumption. The accountant should consider whether the financial forecast, his report, or both require revision. If he concludes that they do not require revision he should request that the inconsistent statements be revised. If they are not revised, he should consider other action such as issuing an adverse report, issuing a scope limitation report, withholding the use of his report in the document, or withdrawing from the engagement.

.17 If the accountant compiles the financial forecast included in the document containing the inconsistent statement, he may conclude that the assumptions supplied by the entity appear to be inappropriate, incomplete, or otherwise unsatisfactory. He should consider whether the presentation or inconsistent statements should be revised. If neither the presentation nor inconsistent statements are revised, the accountant should withhold the use of his report or withdraw from the compilation engagement.

.18 If, while reading the other information appearing in the document containing the reviewed or compiled financial forecast, as described in the preceding paragraphs, the accountant becomes aware of information that he believes is a material misstatement of fact that is not an inconsistent statement, he should discuss the matter with the entity. In connection with this discussion, the accountant should consider that he may not have the expertise to assess the validity of the statement made, that there may be no standards by which to assess its presentation, and that there may be valid differences of judgment or opinion. If the accountant concludes he has a valid basis for concern he should propose that the entity consult with some other party whose advice might be useful, such as the entity's legal counsel.

.19 If after discussing the matter as described in paragraph 500.18 the accountant concludes that a material misstatement of fact remains, the action he takes will depend on his judgment in the particular circumstances. He should consider steps such as notifying the entity in writing of his views concerning the information and consulting his legal counsel as to further appropriate action in the circumstances.

Section 600 Procedures For Compilation Of Financial Forecasts

.01 A compilation of a financial forecast is a professional service that involves:

a. assembly[1], to the extent necessary, of such a financial forecast based on the responsible party's assumptions,

b. consideration of whether, in the accountant's judgment, the underlying assumptions appear to be obviously inappropriate with respect to the financial forecast (see guidance for this consideration in section 600.10), and

c. reading the financial forecast and consideration of whether it appears to be presented in conformity with AICPA presentation guidelines (detailed in section 400).

A compilation is not intended to provide assurance on the financial forecast or the assumptions underlying the forecast. Due to the limited nature of the accountant's procedures, a compilation does not provide assurance that he will become aware of significant matters that might be disclosed by more extensive procedures, for example, those performed in a review of a financial forecast.

.02 During the course of a compilation the accountant may assist the responsible party in identifying and formulating assumptions as well as translating those assumptions into dollar estimates for inclusion in the financial forecast. In assisting his client, the accountant is not required to perform those procedures contemplated by section 300.

.03 The following general guidelines apply to a compilation of a financial forecast and to the resulting report on the forecast:

a. The compilation should be performed by a person or persons with adequate technical training and proficiency to compile financial forecasts.

b. Due professional care should be exercised in the performance of the compilation and preparation of the report.

c. The work should be adequately planned and assistants, if any, should be properly supervised.

1/ See definition of assembly, section 200.14.

d. Applicable compilation procedures should be performed as a basis for reporting on the compiled financial forecast. (See section 600.10.)

e. The report based on the accountant's compilation of a financial forecast should conform to the guidelines in this guide (see section 620).

.04 The concept of materiality is inherent in compilations of financial forecasts as it is in accountants' services with respect to historical financial statements.

Background Knowledge for Compilations

* .05 The accountant should be familiar with guidelines for the preparation and presentation of financial forecasts. Those guidelines are contained in sections 300 and 400, respectively, of this guide.

.06 The accountant should possess a level of knowledge of the industry and accounting principles and practices of the industry in which the entity operates, or will operate, that will enable him to compile financial forecasts that are in appropriate form for an entity operating in that industry. If an accountant has no previous experience in an industry, he can obtain this level of knowledge by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks, periodicals, or individuals knowledgeable about the industry.

.07 To compile the financial forecast of an existing entity, the accountant should obtain a general knowledge of the nature of the entity's business transactions and key factors upon which its future financial results depend. He should also obtain an understanding of the accounting principles and practices of the entity to determine if they are comparable with those used within the industry in which the entity operates. The accountant obtains this knowledge through experience with the entity or inquiry of the entity's personnel.

.08 If the accountant has audited, reviewed, or compiled historical financial statements, or reviewed or compiled previous financial forecasts of the entity, he may already have attained familiarity with the items mentioned above.

.09 To compile the financial forecast of a proposed entity, the accountant should obtain knowledge of the proposed operations and key factors upon which its future results appear to depend and that have affected the performance of entities in the same industry. The accountant can obtain this knowledge in the same manner as described in section 600.06.

Compilation Procedures

* .10 In performing a compilation of a financial forecast the accountant should, where applicable:

a. Establish an understanding with the client, preferably in writing, regarding the services to be performed. (Sample engagement letter excerpts appear in section 610.)

b. Inquire about accounting principles used in the preparation of prospective financial forecasts.

(i) For existing entities, compare these accounting principles to those used in the preparation of previous historical financial statements and inquire whether these are the same as those expected to be used in the historical financial statements covering the prospective period.

(ii) For entities to be formed or formed but that have not commenced operations, compare these accounting principles to those typically used in the industry. Inquire as to whether the accounting principles used for financial forecasts are those that are expected to be used when, or if, the entity commences operations.

c. Ask how the responsible party identifies its key factors and develops its assumptions.

d. List or obtain a list of the responsible party's significant assumptions providing the basis for the financial forecast and consider whether assumptions have been made with respect to all key factors upon which the prospective results of the entity appear to depend.

e. Consider whether, in his judgment, there appear to be any obvious internal inconsistencies in the assumptions.

* f. Based on his knowledge of the entity and its industry consider whether, in his judgment, the assumptions[2/] appear to be obviously inappropriate in light of the expected set of conditions and course of action in the prospective period.

g. Perform or test the mathematical accuracy of the computations made to translate the assumptions into a financial forecast.

* h. Read the financial forecast, including summary of significant assumptions and consider whether:

(i) the forecast, including disclosures of assumptions and accounting policies, appears to be presented in conformity with the guidelines in section 400.

(ii) in his judgment the forecast appears to be obviously inappropriate in relation to:

a. the accountant's knowledge of the entity and industry

b. the expected set of conditions and course of action in the prospective period.

i. If a significant part of the prospective period has expired, consider results of operations for that period.

(i) If historical financial statements have been prepared for the expired portion of the period, the accountant should read such statements and consider those results in relation to the forecast or projection.

2/The accountant should be aware of the Treasury Department's Modified Proposed Regulations on Circular 230 involving tax shelter opinions (see appendix C) which establish certain requirements regarding the accountant's consideration of tax assumptions in tax shelter offering materials.

(ii) If historical financial statements have not been prepared for an expired portion of the prospective period, the accountant should inquire about results of operations or significant portions of the operations (such as sales volume) and consider those results in relation to the financial forecast.

* j. Confirm his understanding of the financial forecast (including assumptions) by obtaining written representations from the responsible party. Since the amounts reflected in the financial forecast are not supported by historical books and records but by assumptions, the accountant should obtain representations in which the responsible party indicates its responsibility for the assumptions. The representations should be signed by the responsible party at the highest level of authority whom the accountant believes is responsible for and knowledgeable, directly or through others, about matters covered by the representations. The representations should include a statement that the presentation is the responsible party's estimate of the expected results for the prospective period based on the expected set of conditions and expected course of action.

k. Consider, after applying the above procedures, whether he has received (1) assumptions that appear to be obviously inappropriate, incomplete, or otherwise unsatisfactory and the effect on the financial forecast appears to be material; or (2) written representations or other information that appear to be obviously inappropriate, incomplete or otherwise unsatisfactory, and if so, attempt to obtain additional or revised assumptions or other such information, including written representations, that would correct the apparent deficiency. If he does not receive such corrective matter, the accountant should withdraw from the compilation engagement.3/

Working Papers

.11 Although it is not possible to specify the form or content of the working papers that an accountant should prepare in connection with a compilation of a financial forecast because of the different circumstances of individual engagements, the accountant's working papers ordinarily should indicate:

a. That the engagement had been planned and that the work of the assistants, if any, had been supervised and reviewed.

b. That the compilation procedures (section 600.10) were performed as a basis for the compilation report.

.12 Some accountants use a checklist or work program similar to that shown in section 600.10 to document the items discussed in the previous paragraph. The inclusion of the checklist would frequently be sufficient documentation of planning, and signing it off after completion of procedures would ordinarily be sufficient documentation of performance.

3/ The accountant need withdraw from the engagement only if the lack of additional or revised assumptions would materially distort the financial forecast. See discussion of materiality, section 600.04.

Section 610 Illustrative Engagement and Representation Letters

* .01 The following is a sample excerpt from an engagement letter for a compilation of a financial forecast:

> This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.
>
> We will compile in accordance with applicable guidelines established by the American Institute of Certified Public Accountants, from information management[1/] provides, the forecasted balance sheet and related statements of income, retained earnings, changes in financial position and summaries of significant assumptions and accounting policies of the XYZ Company as of December 31, 19XX and for the year then ending. We will not express any form of assurance on the achievability of the forecast or reasonableness of the underlying assumptions.
>
> A compilation of prospective financial statements involves assembling prospective financial statements based on management's assumptions and performing certain other procedures with respect to the statements without evaluating the support for, or expressing a conclusion or any other form of assurance on, the assumptions underlying such statements. If, for any reason we are unable to complete our compilation of your financial forecast, we will not issue a report on such statements as a result of this engagement.
>
> A financial forecast presents, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. It is based on management's assumptions, reflecting conditions it expects to exist and the course of action it expects to take.
>
> Management is responsible for representations about its plans and expectations and for disclosure of significant information that might affect the ultimate realization of the forecasted results.
>
> Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variation may be material. Our report will contain a statement to that effect.
>
> We have no responsibility to update our report for events and circumstances occurring after the date of such report.
>
> At the conclusion of the engagement management agrees to supply us with a representation letter which, among other things, will confirm management's responsibility for the underlying assumptions and appropriateness of the prospective financial statements and their presentation.

1/ If the responsible party is other than management, the references to management should be replaced with the name of the third party who assumes responsibility for the assumptions.

In order for us to complete this engagement management must provide assumptions that are appropriate for the forecast. If the assumptions provided are inappropriate and have not been revised to our satisfaction we will be unable to complete the engagement and, accordingly, we will not issue a report on the forecast.

If management intends to reproduce and publish the forecast and our report thereon, they must be reproduced in their entirety and both the first and subsequent corrected drafts of the document containing the forecast and any accompanying material must be submitted to us for approval.2/

* .02 The following is an illustrative representation letter for an engagement to compile a financial forecast. It is presented for illustrative purposes only. The written representations to be obtained should be based on the circumstances.

(Date of Accountant's report)

(To Accountant)

In connection with your compilation of the forecasted balance sheet and related statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX and for the year then ending, we make the following representations:

1. The financial forecast presents our assumptions and, to the best of our knowledge, the Company's expected financial position, results of operations, and changes in financial position for the period, in accordance with the generally accepted accounting principles expected to be used by the company during the forecast period, which are consistent with the principles that XYZ Company uses in preparing its historical financial statements.

2. The financial forecast is based on our judgment, considering present circumstances, of the expected conditions and our expected course of action.

3. We have made available to you all significant information that we believe is relevant to the forecast.

4. We believe that the assumptions underlying the forecast are reasonable and appropriate.

5. To the best of our knowledge and belief, the documents and records supporting the assumptions are appropriate.

6. We believe the forecasted results are achievable; however, the forecast may be favorably or unfavorably affected by many unforeseeable and uncontrollable factors.

(Signatures)

2/ If the assumption regarding income taxes are sensitive, for example in a tax shelter offering, the accountant may wish his engagement letter to provide that the client will obtain a "tax opinion" from its counsel or that the accountant will undertake to apply those procedures necessary to satisfy himself about the tax assumptions.

Section 620 The Accountant's Report On Compiled Financial Forecasts

* .01 The accountant's standard report on a compilation of a financial forecast should include (except as discussed in section 630):

a. An identification of the financial forecast presented by the responsible party and a description of what it is intended to represent.

b. A statement that the accountant has compiled the financial forecast in accordance with guidelines established by the American Institute of Certified Public Accountants.

c. A statement that the accountant assumes no responsibility to update the report for events and circumstances occuring after the date of the report.

d. A statement that a compilation is limited in scope and does not enable the accountant to express a conclusion or any other form of assurance on the financial forecast.

e. A caveat regarding the ultimate attainment of the prospective results.

.02 The accountant's report may also present other information and comments the accountant wishes to include, such as explanatory comments or other informative material. If the accountant presents other information he should not appear to be expressing assurance or expanding the degree of responsibility he is taking with respect to such information. For example, the accountant should not include statements in his report about the mathematical accuracy of the statements or their conformity with presentation guidelines.

.03 If an accountant compiles a financial forecast in conjunction with a review of the forecast he need report only on the review (see section 720).

* .04 The following is the form of the standard report for the compilation of a financial forecast[1/]:

> The accompanying forecasted balance sheet,[2/] statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's[3/] knowledge,

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1/ This form of report is appropriate whether the presentation is based on generally accepted accounting principles or an other comprehensive basis of accounting.

2/ When the presentation is summarized as discussed in section 400.03 this sentence might read "The accompanying financial forecast of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and accounting policies, presents, to the best of management's knowledge, a summary of the expected results of operations and changes in financial position for the forecast period."

3/ When the responsible party is other than management, the references to management in the standard report should be changed to refer to that third party who assumes responsibility for the assumptions.

the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

We have compiled the forecast in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a forecast does not include evaluation of the support for the assumptions underlying the forecast. Because a compilation of a forecast is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

.05 The date of completion of the accountant's compilation procedures should be used as the date of the report.

Reporting on Compiled Financial Forecasts That Omit Certain Disclosures

.06 An entity may request an accountant to compile a financial forecast that omits disclosures other than those relating to significant assumptions[4]. The accountant may compile such a financial forecast provided the omission is clearly indicated in his report and is not, to his knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such statements.

.07 Notwithstanding the above, if a compiled financial forecast presented on a comprehensive basis of accounting other than generally accepted accounting principles does not include disclosure of the basis of accounting used, the basis should be disclosed in the accountant's report.

.08 The following is an example of a report on a compiled financial forecast in which the summary of significant accounting policies has been omitted. (The added paragraph is underscored).

The accompanying forecasted balance sheet, statements of income, retained earnings, and changes in financial position and summary of significant assumptions of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may

4/If any of the minimum items in section 400.03 (a) through (h) is omitted, the presentation is a partial presentation. See section 2000.

occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

We have compiled the forecast in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a forecast does not include evaluation of the support for the assumptions underlying the forecast. Because a compilation of a forecast is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Management has elected to omit the summary of significant accounting policies required by the guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants. If the omitted disclosures were included in the forecast, they might influence the user's conclusions about the Company's financial position, results of operations, and changes in financial position for the forecast period. Accordingly, this forecast is not designed for those who are not informed about such matters.

Reporting When the Accountant is Not Independent

.09 An accountant may issue a report on his compilation of a financial forecast for an entity with respect to which he is not independent.[5/] If the accountant is not independent, he should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, he may give the standard report but should include the following after the last paragraph of his report:

We are not independent with respect to XYZ Company.

Emphasis of a Matter

.10 In some circumstances, the accountant may wish to emphasize a matter regarding the financial forecast. Such information may be presented in a separate paragraph of the accountant's report. The accountant should exercise care, however, that emphasizing such a matter does not give the impression that he is extending his responsibility.

Documents Also Containing Historical Financial Statements

.11 A financial forecast may be included in a document that also contains historical financial statements and the accountant's report thereon.[6/] In addition, the historical

5/ In making a judgment about whether he is independent, the accountant should be guided by the AICPA Code of Professional Ethics. Also see the auditing interpretation on "Applicability of Guidance on Reporting When Not Independent" (AICPA Professional Standards, Vol. 1, AU Section 9504.19-22).

6/ The accountant's responsibility with respect to those historical financial statements upon which he is not engaged to perform a professional service is described in SAS No. 26, in the case of public entities, and SSARS 1, in the case of nonpublic entities.

financial statements that appear in the document may be summarized and presented with the financial forecast for comparative purposes.7/ An example of the reference to the accountant's report on the historical financial statements when he audited, reviewed, or compiled those statements is presented below:

(concluding sentence of first paragraph)

...The historical financial statements for the year ended December 31, 19XX (from which the historical data is derived) and our report thereon are set forth on pages xx-xx of this document.

Other Reporting Examples

.12 The following is an example of a report on compilations of a financial forecast for one period and of a multiple projection for a later period:

The accompanying forecasted balance sheet, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19X1, and for the year then ending, present, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

The accompanying projected balance sheets, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19X2, and for the year then ending, present, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period (describe or refer to hypothetical assumptions, e.g., "predicated on occupancy rates of 60% and 80% of available apartments, as disclosed in items b and c of the summary of significant assumptions"). Accordingly, the financial projections reflect its judgment, based on present circumstances, of the expected conditions and its expected course of action (describe hypothetical assumptions, e.g., "at each occupancy rate"). Management expects, to the best of its knowledge, that the actual (hypothetical assumption, e.g., "occupancy rate") achieved will be within the range shown; however, there can be no assurance that it will. However, even if the actual (hypothetical assumption, e.g., "occupancy rate") achieved is within the range shown, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period may vary materially outside the range presented by the projections.

We have compiled the forecast and projections in accordance with applicable guidelines established by the American Institute of Certified Public Accountants.

7/ SAS No. 42 discusses the accountant's report where summarized financial statements are derived from audited statements that are not included in the same document.

> A compilation of a forecast and projection does not include evaluation of the support for the assumptions underlying the forecast and projection. Because a compilation of a forecast and projection is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

.13 The following is an example of an accountant's report when he is engaged to review (see section 720) a forecast for one period and compile a forecast for a later period:

> The accompanying forecasted balance sheets, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19X1 and 19X2, and for the years then ending, present, to the best of management's knowledge, the Company's expected financial positions, results of operations, and changes in financial positions for the forecast periods. Accordingly, the financial forecasts reflect its judgment, based on present circumstances, of the expected conditions and its expected course of action.
>
> We have reviewed the forecast as of December 31, 19X1, and for the year then ending, in accordance with applicable guidelines for a review of a financial forecast established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. Based on our review, we believe that the accompanying forecast as of December 31, 19X1, and for the year then ending, is presented in conformity with applicable guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants. We believe that the underlying assumptions provide a reasonable basis for management's forecast.
>
> We have compiled the forecast as of December 31, 19X2, and for the year then ending, in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a forecast does not include evaluation of the support for the assumptions underlying the forecast. Because a compilation of a forecast is limited as described above, we do not express a conclusion or any other form of assurance on the statements or assumptions at December 31, 19X2, and for the year then ending.
>
> Some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast periods will vary from the forecasts and the variations may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Section 630 **Compilations of Financial Forecasts for Internal Use Only**

.01 The accountant may compile a financial forecast for which distribution is intended to be limited to the responsible party. The procedural and reporting guidelines discussed in sections 600-620 generally apply to compilations of financial forecasts for internal use only, but may be modified as discussed in this section.

Procedures

.02 Engagement Letters. If the accountant uses an engagement letter, he may wish to specify in the letter that the financial forecast and his report are not to be distributed to outside users.

.03 Expired Portions of the Prospective Period. If a significant part of the prospective period has expired, the accountant should inquire about the results of operations for the expired period and consider those results in relation to the financial forecast. The accountant may wish to read any historical financial statements prepared for the expired portion of the prospective period.

.04 Representations. The accountant should confirm his understanding of the financial forecast, including assumptions, but may do so orally.

Reporting

.05 The form and content of a report on a compilation of a financial forecast for internal use only is more flexible than for the compilation reports described in section 620. However, when the accountant performs the service described in this section, his report, at a minimum, should:[1]

a. be addressed to the responsible party

b. identify the statements being compiled

c. identify the objective of the engagement

d. indicate the level of assurance[2] he is giving with regard to the assumptions without vouching for the achieveability of the prospective results.

e. indicate the restrictions as to the distribution and usefulness of the financial forecast and report.

f. state that the accountant has no responsibility to update his report for events and circumstances occurring after the date of his report

g. be dated as of the date of the completion of his compilation procedures

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1/ The accountant should also consider the guidance in Ethics rule 201(e) and related interpretation on reporting on prospective financial statements (see excerpts in section 2000.05).

2/ The accountant's assurance as to the assumptions should not be similar to that given on a review of a financial forecast unless he complies with the procedures for a review in section 700.

.06 In addition to the above, where applicable the accountant's report should:

- o indicate if he is not independent with respect to the entity
- o describe any omission of any disclosures (see section 620.06).

Section 700 Procedures for Reviews of Financial Forecasts

.01 A review of a financial forecast is a professional service that involves evaluation of:

(a) the preparation of the financial forecast,

(b) the support underlying the assumptions, and

(c) the presentation of the financial forecast for conformity with AICPA presentation guidelines (detailed in section 400).

* .02 As a result of his reivew the accountant has a basis for reporting on whether the financial forecast is presented in conformity with AICPA guidelines and whether the assumptions provide a reasonable basis for the responsible party's forecast.

.03 Before the accountant undertakes to perform such a service he should consider whether the financial forecast is susceptible to review (see section 500.08).

.04 The accountant and the responsible party should reach an understanding as to services to be provided. Ordinarily, this understanding is confirmed in an engagement letter. (See section 710 for illustrative engagement letter excerpts.)

.05 The following guidelines apply to a review of financial forecasts and to the resulting report.

a. The review should be performed by a person or persons with adequate technical training and proficiency to review financial forecasts.

b. In all matters relating to the engagement, the accountant should maintain an independence in mental attitude.1/

c. Due professional care should be exercised in the performance of the review and the preparation of the report.

d. The work should be adequately planned and assistants, if any, should be properly supervised.

1/ In making a judgment about whether he is independent, the accountant should be guided by the AICPA Code of Professional Ethics. Also see the auditing interpretation "Applicability of Guidance on Reporting When Not Independent" (AICPA Professional Standards, Vol. 1, AU Section 9504.19-22).

e. The accountant should obtain an understanding of the process by which the responsible party develops its financial forecasts as a basis for determining the scope of the rview.

f. Appropriate support should be obtained to afford a reasonable basis for the accountant's report.

* g. The report based on the accountant's review should contain a statement regarding whether the accountant believes the financial forecast is presented in conformity with applicable AICPA presentation guidelines and has been prepared using assumptions that provide a reasonable basis for the responsible party's forecast.

.06 The concept of materiality is inherent in a review of financial forecasts as it is in accountant's services with respect to historical financial statements.

.07 The specific program of review should be developed giving consideration to the matters discussed below. (Section 700.41 illustrates possible review procedures.)

The Scope of the Review

.08 Factors affecting the scope of the accountant's review include knowledge of the entity's business and its industry, the responsible party's experience in preparing financial forecasts, the forecasting period, and the process by which the responsible party develops its financial forecasts.

Knowledge of the Entity's Business and its Industry

.09 The accountant should obtain knowledge of the entity's business, accounting principles, and the key factors upon which its future financial results appear to depend, in a manner similar to that described in Section 600.05 through 600.09. The accountant should focus on such areas as:

a. Availability and cost of resources needed to operate. Principal items usually include raw material, labor, short and long-term financing, and plant and equipment.

b. The nature and condition of markets in which the entity sells its goods or services, including final consumer markets if the entity sells to intermediate markets.

c. Factors specific to the industry, including competitive conditions, sensitivity to economic conditions, accounting policies, specific regulatory requirements, and technology.

d. Patterns of past performance for the entity or comparable entities, including trends in revenue and costs, turnover of assets, uses and capacities of physical facilities, and management policies.

.10 If the accountant has reviewed or examined the entity's historical financial statements or reviewed or compiled previous financial forecasts, he may be generally familiar with certain of these areas2/. However, the accountant may acquire or augment this knowledge in other ways, such as by inquiry of entity personnel, by experience with other similar entities in the industry, by consultation with individuals knowledgeable about the industry, and by use of industry publications, financial statements of other entities in the industry, textbooks, and periodicals.

The Responsible Party's Experience in Preparing Financial Forecasts

.11 Analysis of any financial forecasts developed for past periods compared to the historical results for those periods may indicate the effectiveness of the process to prepare financial forecasts. However, the responsible party's previous experience is not necessarily indicative of the reliability of the forecast under review.

Prospective Period

.12 The accountant should consider the length of the prospective period and the extent to which historical results are included in the period.3/ These two factors may affect the amount and reliability of support for the assumptions underlying the financial forecast.

Process By Which the Responsible Party Develops its Financial Forecasts

.13 The accountant's understanding of this process helps determine the scope of the review. The accountant's initial understanding usually is obtained in discussions with personnel responsible for the presentation. More detailed understanding, including the process by which the key factors are identified and assumptions are developed, reviewed, and approved, is generally obtained through inquiry; observation; review of manuals, memoranda, instructions, and forms used (if any); analysis of models and statistical techniques (if used); and review of documentation. The extent to which the accountant obtains or develops documentation in support of the assumptions will depend upon the complexity of the process.

.14 In determining the scope of his review the accountant should consider the process in relation to the guidance in Section 300.4/

Procedures to Evaluate Assumptions

.15 Generally, the responsible party's assumptions are readily identifiable from (1) the summary of significant assumptions and (2) analysis of the more detailed data included in the documentation.

2/ See Statement on Auditing Standards 22, paragraphs 7-8, and Statement on Standards for Acconting and Review Services 1, paragraphs 24-26.

3/ See Section 400.26-.28.

4/ The accountant's consideration of the process may also provide a basis for constructive suggestions concerning improvements in the process used to develop financial forecasts.

* .16 The accountant should perform those procedures he considers necessary in the circumstances to report on whether the assumptions provide a reasonable basis for the forecast. The accountant can conclude that the assumptions provide a reasonable basis for the forecast if the responsible party represents the presentation reflects, to the best of its knowledge, its estimate of expected financial position, results of operations and changes in financial position for the prospective period (section 700.36) and he concludes based on his review (1) that the responsible party has explicitly identified all factors expected to materially affect the operations of the entity during the prospective period and has developed appropriate assumptions with respect to such factors[5] (section 700.20) and (2) that the assumptions are suitably supported (section 700.22).

Development of Assumptions

.17 Using his knowledge of the business, the accountant should evaluate whether assumptions have been developed for all key factors upon which the entity's financial results appear to depend. In evaluating the assumptions, the accountant should consider the relevance and overall completeness of the factors identified as well as risks inherent in the business and the sensitivity of the financial forecast to variations in particular assumptions.

.18 Analyzing prior-period financial statements may help identify the principal factors that influence financial results. The accountant should consider whether any significant deviations from historical trends exist, including deviations from historical results included for a part of the prospective period. The deviations might highlight significant factors that previously were not deemed important to the business.

Support for Assumptions

.19 Having satisfied himself that all key factors have been identified and assumptions have been developed for each key factor, the accountant should evaluate the support for assumptions.

* .20 The accountant can conclude that assumptions are suitably supported if the preponderance of information supports each significant assumption.

.21 As used here "preponderance" is not meant to imply that a statistical majority of available information points to a specific assumption. Rather, a preponderance of information exists for an assumption if the weight of available information tends to support that assumption. Further, because of the judgments involved in developing assumptions, different people may arrive at different but equally reasonable assumptions based on the same information and each have a preponderance of information in support of his assumption.

.22 In his evaluation, the accountant should consider the assumptions in the aggregate as a basis for the financial forecast. If certain assumptions have no material impact on the presentation, they may not have to be individually evaluated. Nonetheless, the accountant should consider the aggregate impact of individually insignificant assumptions in evaluating whether the assumptions provide a reasonable basis for the financial forecast.

5/ An attempt to list all assumptions is inherently not feasible. Frequently, basic assumptions that have enormous potential impact are considered to be implicit, such as conditions of peace and absence of natural disasters.

.23 The financial forecast the accountant is engaged to review is defined in terms of the responsible party's estimate, to the best of its knowledge, of expected future results based on expected conditions and courses of action. Although the accountant can reach a conclusion that the assumptions provide a reasonable basis for the presentation, he cannot conclude that any outcome is expected because (a) realization of the financial forecast may depend upon the responsible party's intentions, which cannot be reviewed, (b) there is substantial inherent uncertainty in the assumptions, (c) some of the information accumulated about an assumption may appear contradictory, and (d) different but similarly reasonable assumptions concerning a particular matter might be derived from common information.

.24 The accountant should concentrate his effort on specific assumptions that are:

- Material to the prospective amounts
- Especially sensitive to variations
- Deviations from historical trends
- Especially uncertain

.25 In evaluating the support for assumptions, the accountant should consider the following matters:

a. Whether sufficient pertinent sources of information about the assumptions have been considered. Examples of external sources the accountant might consider are government publications, industry publications, economic forecasts, existing or proposed legislation, and reports of changing technology. Examples of internal sources are budgets, labor agreements, patents, royalty agreements, engineering studies, historical financial statements and records, sales backlog records, debt agreements, and board of directors actions involving entity plans.

b. Whether the assumptions are consistent with the sources from which they are derived.

c. Whether the assumptions are consistent with each other.

d. Whether the historical financial information and other data used in developing the assumptions are sufficiently reliable for that purpose. Reliability can be assessed by inquiry and analytical or other procedures, some of which may have been completed in past examinations, or reviews of the historical financial statements.

e. Whether the historical financial information and other data used in developing the assumptions are comparable over the periods specified or whether the effects of any lack of comparability were considered in developing the assumptions.

f. Whether the logical argument or theory, considered with the data supporting the assumptions, is reasonable.

.26 Support for assumptions may include market surveys, engineering studies, general economic indicators, industry statistics, trends and patterns developed from an entity's operating history, and internal data and analyses, accompanied by their supporting logical argument or theory. The accountant may also obtain support during the evaluation of the process by which the responsible party develops its financial forecasts. Support can range from information based on informed opinion (such as economists' estimates of the inflation rate) to data that can be tested in traditional ways (such as completed transactions).

.27 In addition to evaluating the assumptions and the sources of information used to develop them, the accountant should consider using alternative approaches to the development of assumptions in evaluating forecasted amounts. For example, to test a forecast of aggregate sales developed from individual salesmen's estimates the accountant may employ an historical trend estimate.

Support of Tax Assumptions

.28 Sometimes, one of the most sensitive assumptions underlying a financial forecast relates to the income tax treatment of prospective transactions. This is usually the case for financial forecasts used for tax shelter offerings.6/ Where this is the case the accountant should satisfy himself as to the appropriateness of the tax assumptions either (1) by obtaining an opinion about those tax consequences from the entity's tax counsel (a "tax opinion") or (2) through his own inquiry and analysis.

Procedures to Evaluate the Preparation and Presentation of the Financial Forecast

.29 In evaluating the preparation and presentation of the financial forecast, the accountant should perform procedures that will provide reasonable assurance of the following:

a. The presentation reflects the identified assumptions.

b. The computations made to translate the assumptions into prospective amounts are mathematically accurate.

c. The assumptions are internally consistent.

* d. Accounting principles used in the forecast are consistent with the accounting principles expected to be used in the historical financial statements covering the forecast period and those used in the most recent historical financial statements, if any, (although a different basis of accounting may be used in the forecast than is expected to be used in the historical financial statements, see section 400.11).

e. The presentation of the financial forecast follows the guidelines in Section 400.

f. The assumptions have been adequately disclosed, based upon the presentation guidelines in Section 400.

6/ The accountant should be aware of the Treasury Department's Modified Proposed Regulations on Circular 230, Involving Tax Shelter Opinions (see Appendix C) which establish certain requirements regarding the accountant's consideration of tax assumptions in tax shelter offering materials.

.30 The accountant should consider whether the financial forecast, including related disclosures, should be revised because of (a) mathematical errors, (b) unreasonable or internally inconsistent assumptions, (c) inappropriate or incomplete presentation, or (d) inadequate disclosure.

Written Representation

.31 The accountant should obtain written representation from the responsible party acknowledging its responsibility for both the presentation and the underlying assumptions.

* .32 Such representations should include a statement that the financial forecast presents, to the best of the responsible party's knowledge, the expected financial position, results of operations, and changes in financial position for the forecast period and that the forecast reflects the responsible party's judgment, based on present circumstances, of the expected conditions and its expected course of action.

.33 The representation should be signed by the responsible party at the highest level of authority whom the accountant believes is responsible for and knowledgeable, directly or through others in the organization, about the matters covered by the representations. Section 710 contains illustrative representation letters.

Historical Financial Results

.34 If historical financial statements have been prepared for an expired part of the prospective period, the accountant should consider the historical data in relation to the prospective results for the same period, where applicable. If the financial forecast incorporates the historical financial results and that period is significant to the presentation, the accountant should make a review of the historical information in conformity with applicable standards for a review.7/

Using the Work of a Specialist

.35 During his review, the accountant may encounter matters that in his judgment require using the work of a specialist, for example an engineer, economist, investment banker, or architect. Although the guidance provided in Statement on Auditing Standards No. 11 is intended for the auditor of historical financial statements, it is generally applicable when the accounant reviewing a financial forecast uses the work of a specialist.

Working Papers

.36 Working papers should be appropriate to the circumstances and the accounant's needs on the engagement to which they apply. Although the quantity, type, and content of working papers vary with the circumstances, they ordinarily should indicate:

a. That the engagement had been adequately planned and that the work of assistants had been supervised.

b. That the process by which the entity develops its financial forecasts had been considered in determining the scope of the review.

7/ If the entity is a public company, the accountant should perform the procedures in Statement on Auditing Standards No. 36, Review of Interim Financial Information, paragraphs 6-15. If the entity is nonpublic, the accountant should perform the procedures in Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements, paragraphs 24-31.

c. That appropriate support had been obtained to provide a reasonable basis for the accountant's report.

Illustrative Review Procedures

.37 The following procedures are listed to assist the accountant in planning reviews of financial forecasts. The list is neither a complete summary of all possible procedures, nor an outline of minimum procedures, but it should aid in the development and selection of procedures for a particular engagement. The accountant may be able to achieve the same objectives by procedures other than those illustrated.

.38 Although the responsible party may call upon the accountant to assist in identifying and formulating assumptions as well as translating those assumptions into dollar estimates for inclusion in the financial forecast, the accountant is responsible to perform review procedures to obtain appropriate support to afford a reasonable basis for his report.

.39 The procedures are divided into three categories:

- o Procedures to determine the scope of the review.
- o Procedures to evaluate assumptions.
- o Procedures to evaluate the preparation and presentation of the financial forecast.

.40 Procedures to Determine the Scope of the Review

a. Obtain knowledge of the entity's business by

(1) Interviewing entity personnel and other individuals knowledgeable about the industry.

(2) Consulting AICPA guides, industry publications, textbooks, and periodicals.

(3) Analyzing financial statements of the entity and of other entities in the industry.

The accountant may have previously obtained some of this knowledge through experience with the entity or its industry.

b. Obtain, prepare, or update an analysis of the following items:

(1) Resources needed by the company (availability and cost).

Material

Labor

Capital

Fixed assets (e.g., capacity of plant and equipment)

(2) Markets served by the company (nature and condition).

Intermediate markets

Final consumer markets

Entity's market share

Advertising and marketing plans

(3) Factors specific to the industry.

Competitive conditions

Sensitivity to economic conditions

Accounting policies

Specific regulatory requirements

Technology

(4) Patterns of past performance for the entity or comparable entities.

Trends in revenue and costs

Turnover of assets

Uses and capabilities of physical facilities

Management policies

c. Obtain or assemble the financial forecast together with a list of the significant assumptions and their descriptions.

d. Review the process used in preparing the financial forecast to obtain an understanding of the rationale by which key factors are identified and assumptions are developed and of the process by which assumptions are translated into prospective data. The accountant would look for answers to such questions as these:

(1) Is preparation of the financial forecast adequately documented to permit tracing through the process? The accountant may decide to prepare a brief outline of the process used to develop financial forecasts.

(2) If the process has been used in the past to generate financial forecasts, was it effective?

(3) What procedures provide reasonable assurance that all significant factors are included in the assumptions?

(4) What procedures provide reasonable assurance that the financial forecast is based on assumptions approved by the responsible party?

(5) What are the methods for collecting, calculating, and aggregating prospective data?

(6) What methods identify and quantify the impact of variations in assumptions?

(7) What accounting principles are used in the financial forecast?

(8) What are the procedures to reflect changes in accounting principles in the financial forecast?

(9) If the process used to develop financial forecasts has been in operation or used in the past, are there procedures to compare prior prospective amounts with the historical results for the same period and analyze the differences where applicable (for example, differences in forecasted amounts and actual results should be analyzed to ascertain that identified causes are considered)? Are the procedures used to adjust the process, where applicable, as a result of such analysis?

(10) What are the responsible party's review and approval procedures?

(11) How are errors prevented or detected?

e. Identify any models and techniques that are used. If possible, obtain a description of them.

f. Having reviewed the process by which the responsible party develops its financial forecasts, analyze its strengths and weaknesses, comparing it with the guidelines outlined in Section 300.

g. Consider the competence of entity's personnel involved in the process, including their degree of authority, prior experience with the entity and industry, and understanding of both the entity's plans and the process, in relation to their functions in the process and in entity operations.

h. Review documentation of both the financial forecasts and process to develop them or otherwise investigate whether there is:

(1) Review and approval by the responsible party.

(2) Determination of the relative effect of variations in major underlying assumptions.

(3) Use of the appropriate accounting principles and practices.

i. Test significant elements of the process designed to prevent or detect errors, including clerical errors.

j. Where applicable, review the entity's documentation of the comparison of actual results with amounts contained in previous financial forecasts (if any) and consider (a) whether the comparison was performed using correct, comparable data and whether analyzed differences were documented and appropriately supported, (b) whether the process was adjusted where appropriate, (c) whether the procedures to develop financial forecasts in the past have reflected the entity's plans properly, and (d) whether any consistent biases have been observed.

k. Based on the knowledge obtained in the foregoing procedures, design the review procedures for evaluating assumptions and evaluating the preparation and presentation of the financial forecast.

.41 <u>Procedures to Evaluate Assumptions</u>

a. Identify key factors upon which the financial results of the entity appear to depend.

(1) Evaluate both the assumptions listed in the financial forecast and the more detailed data included in the underlying documentation to determine the completeness of the list. Factors to consider include:

Risks inherent in the business.

Sensivity to variations.

Pervasiveness of the impact of particular factors on the various assumptions.

(2) Obtain financial forecasts of similar entities, if available, and consider whether the key factors covered by the assumptions therein are covered in the client's statements.

(3) Analyze prior-period financial results to help identify the principal factors that influenced the results. If any interim historical results are available, consider any significant deviations from historical patterns and investigate the causes.

(4) Review any public statements, formal plans, and the minutes of board of directors meetings, noting any significant decisions regarding plans, contracts, or legal agreements.

(5) Question the responsible party regarding possible additional factors or changes in assumptions about factors.

(6) Using knowledge of the entity and its industry, investigate any particularly risky or sensitive aspect of the business - market trends, competitive conditions, pending laws and regulations, social, economic, political and technological influences, and dependence upon major customers and suppliers.

* b. Evaluate whether the assumptions are suitably supported.

(1) Evaluate the suppport for the assumptions, giving special attention to specific assumptions that are:

Material to the prospective values

Especially sensitive to variations

Deviations from historical patterns

Especially uncertain

(2) For key assumptions, obtain a list of internal and external sources of information that the entity used in formulating the assumptions. On a test basis, evaluate whether the information was considered in formulating the assumptions.

(3) Trace assumptions about selected key factors to the support for the assumptions to determine whether the indicated sources of information were actually used and evaluate the suitability of existing support. If the information is taken from internal analyses, consider the need for testing the supporting information.

(4) Review any available documentation of the responsible party's plans, such as budgets, spending estimates, policy statements, contractual agreements, etc., and inquire about those plans, goals, and objectives and consider their relationship to the assumptions.

(5) Investigate alternative sources of support for the assumptions and evaluate whether the preponderence of accumulated information supports each significant assumption.8/

(6) Inquire about and analyze the historical data used in developing prospective amounts to assess:

Whether it is comparable and consistent with the period specified.

Whether it is sufficiently reliable for the purpose.

(7) If historical financial statements have been prepared for an expired part of the prospective period, read the historical data and consider them in relation to the prospective results for the same period.

(8) If the financial forecast incorporates the historical financial results and that period is significant to the presentation, make a review of the historical information in conformity with applicable standards for a review.

8/ The cost to acquire the additional information should be commensurate with anticipated benefits. See Section 313.02.

(9) Consider alternative approaches to the development of the assumptions. For example, if the sales assumption was developed by aggregating individual salesmen's estimates, consider comparing the assumptions to historical patterns. Also consider trying other models and techniques.

(10) Evaluate whether the presentation extends to time periods for which suitable support for assumptions is not available, considering:

The nature of the entity's industry.

Patterns of past performance for the entity or comparable entities.

(11) Where appropriate, consider confirming with external sources information supporting the assumptions (for example, if the backlog of orders is significant to the financial forecast and is not adequately supported, consider sending written confirmation requests to customers).

(12) If the support for key assumptions comes from experts such as lawyers, engineers, economists, investment bankers, and architects,

Consider their professional standing.

Consider using the work of another expert in the field.

Review the data and plans the entity submitted to the expert for consistency with the financial forecast and supporting data.

(13) If the assumptions about the tax treatment of prospective transactions are sensitive, obtain support for their appropriateness by analyzing prospective transactions in the context of applicable tax laws or by obtaining an opinion as to such matters from the entity's tax counsel.

(14) Obtain a representation letter from the responsible party.

(15) Consider obtaining a letter from the client's legal counsel, as of the report date, covering

Litigation, claims and assessments.

Legality of any major changes planned (such as marketing considerations, environmental impact, or patents) and other matters (such as the impact of new laws affecting the industry).

* .42 <u>Procedures to Evaluate the Preparation and Presentation of the Financial Forecast</u>

a. Test the mathematical accuracy of or perform the computations made in translating the assumptions into prospective amounts.

b. Evaluate whether data have been appropriately aggregated by

(1) Evaluating the appropriateness of mathematical equations, statistical techniques or modeling procedures.

(2) Recomputing on a test basis.

(3) Tracing aggregate amounts to the financial forecast.

c. Determine whether the listed assumptions are those used in preparing the financial forecast.

d. Determine whether the effects of each assumption on all of the related prospective amounts have been reflected in the presentation.

e. Determine whether any assumption contradicts or is inconsistent with another.

f. Review the relationship between financial and other relevant data using appropriate mathematical or judgmental methods.

g. Review adjustments made in the data, considering whether they are justified and reasonable in relation to other information, and whether their impact has been properly reflected in the financial forecast.

h. If historical data are included in the financial forecast, trace the amounts from the books, records, and other indicated sources to the final financial forecast.

i. Determine whether the presentation is in conformity with the presentation guidelines in Section 400 considering the following:

(1) Is the financial forecast presented in the format of the historical financial statements expected to be issued? If not, are the minimum items presented?

(2) Are the accounting principles used:

Consistent with those used in the historical financial statements, if any?

Consistent with those expected to be used in future financial statements (including expected changes in accounting principles)?

Reconciled to historical methods where different?

Generally accepted accounting principles or based on an other comprehensive basis of accounting?

(3) Is the basis of accounting used: Consistent with that used in historical financial statements, if any?

Reconciled with the historical methods where different?

(4) Is the financial forecast expressed in specific monetary amounts?

(5) Are the assumptions adequately disclosed?

(6) Are sensitive assumptions identified?

(7) Is the relative impact of a variation disclosed for each material, sensitive assumption?

(8) If the impact of a variation in an assumption is disclosed is it appropriately stated?

(9) Is the financial forecast appropriately distinguished from historical financial statements?

Section 710 Illustrative Engagement and Representation Letters

* .01 The following is a sample excerpt from an engagement letter for a review of a financial forecast:1/

This letter confirms our understanding of the arrangement for our review of the financial forecast of XYZ Company as of December 31, 19XX and the year then ending for the purpose of issuing a report stating whether we believe (1) management's financial forecast is presented in conformity with applicable guidelines established by the American Institute of Certified Public Accountants and (2) management's assumptions provide a reasonable basis for its forecast.

Our review will be made in accordance with applicable guidelines of the American Institute of Certified Public Accountants for a review of a financial forecast and, accordingly, will include procedures we consider necessary to evaluate (a) the assumptions used by management as a basis for the financial forecast, (b) the preparation of the financial forecast, and (c) the presentation of the financial forecast.

A financial forecast presents, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. It is based on management's assumptions reflecting conditions it expects to exist and the course of action it expects to take.

Management is responsible for representations about its plans and expectations and for disclosure of significant information that might affect the ultimate realization of the forecasted results.

Some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur; therefore the actual results achieved during the forecast period will vary from the forecast and the variations may be material. Our report will contain a statement to that effect.

We have no responsibility to update our report for events and circumstances occurring after the date of our report.

At the conclusion of the engagement, management agrees to supply us with a representation letter which, among other things, will confirm management's responsibility for the underlying assumptions and the appropriateness of the prospective financial statements and their presentation.

Our report will detail the nature of reservations (if any) we have with respect to the forecast. Should any such reservation develop, we will discuss them with you before the report is issued.

1/ If the assumptions regarding income taxes are sensitive, for example, in a tax shelter offering, the accountant may wish his engagement letter to provide that the client will obtain a "tax opinion" from its counsel or that the accountant will undertake to apply those procedures necessary to satisfy himself about the tax assumptions.

If management intends to reproduce and publish the forecast and our report thereon, they must be reproduced in their entirety and both the first and subsequent corrected drafts of the document containing the forecast and any accompanying material must be submitted to us for approval.

.02 The following is a sample representation letter for a review of a financial forecast. The written representations to be obtained should be based on the circumstances of the engagement.

(Date of Accountant's report)

(To Accountant)

In connection with your review of the forecasted balance sheet and related statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX and for the year then ending, we make the following representations:

(1) The financial forecast presents our assumptions and, to the best of our knowledge, the Company's expected financial position, results of operations, and changes in financial position for the period, in accordance with the generally accepted accounting principles expected to be used by the company during the forecast period, which are consistent with the principles that XYZ Company uses in preparing its historical financial statements.

(2) The financial forecast is based on our judgment, considering present circumstances, of the expected conditions and our expected course of action.

(3) We have made available to you all significant information that we believe is relevant to the forecast.

(4) We believe that the assumptions underlying the forecast are reasonable and appropriate.

(5) To the best of our knowledge and belief, the documents and records supporting the assumptions are appropriate.

(6) We believe the forecasted results are achievable; however, the forecast may be favorably or unfavorably affected by many unforeseeable and uncontrollable factors.

(Signatures)

Section 720 The Accountant's Report On Reviewed Financial Forecasts

Accountant's Standard Report

*.01 The accountant's standard report on a review of a financial forecast should include:

a. An identification of the financial forecast presented and a description of what it is intended to represent.

b. A statement that the review of the financial forecast was made in accordance with applicable AICPA guidelines and a brief description of the nature of such a review.

c. A statement that the accountant assumes no responsibility to update the report for events and circumstances occurring after the date of the report.

d. A statement regarding whether the accountant believes that the financial forecast is presented in conformity with applicable AICPA presentation guidelines1/ and whether the underlying assumptions provide a reasonable basis for the presentation.

e. A caveat regarding the ultimate attainment of the prospective results.

.02 The form of the standard report on a review of a financial forecast is as follows:2/

> The accompanying forecasted balance sheet,3/ statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's4/ knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action.

1/ The accountant's report need not comment on the consistency of the application of accounting principles as long as the presentation of any change in accounting principles is in conformity with the guidelines in Section 400.

2/ This form of report is appropriate whether the presentation is based on generally accepted accounting principles or an other comprehensive basis of accounting.

3/ When the presentation is summarized as discussed in section 400.03 this sentence might read "The accompanying financial forecast of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and accounting policies, presents, to the best of management's knowledge, a summary of the expected results of operations and changes in financial position for the forecast period."

4/ When the responsible party is other than management, the references to management in the standard report should be changed to refer to that third party who assumes responsibility for the assumptions.

We have reviewed the forecast in accordance with applicable guidelines for a review of a financial forecast established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Based on our review, we believe that the accompanying forecast is presented in conformity with applicable guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants. We believe that the underlying assumptions provide a reasonable basis for management's forecast. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

.03 The date of completion of the accountant's review procedures should be used as the date of the report. The report may also present other information and comments the accountant wishes to include, such as explanatory comments or other informative material.

Circumstances Resulting in Departure From Accountant's Standard Report

.04 The circumstances that result in a departure from the accountant's standard report are as follows:4/

a. The accountant believes that the financial forecast departs from the presentation guidelines discussed in Section 400. (See Section 720.06.)

* b. The accountant believes one or more significant assumptions do not provide a reasonable basis for the forecast. (See Section 720.09.)

c. The scope of the accountant's review is affected by conditions that preclude application of one or more procedures he considers necessary in the circumstances. (See Section 720.11.)

d. The accountant is not independent. (See Section 720.17.)

e. The accountant's evaluation is based in part on the report of another accountant. (See Section 720.18.)

f. Historical financial information is presented for comparison to the financial forecast. (See Section 720.19.)

g. The accountant wishes to emphasize a matter regarding the financial forecast. (See Section 720.20.)

4/ In situations where the presentation, assumptions, or other information is inappropriate, incomplete, or otherwise unsatisfactory, the accountant should request that the entity revise the presentation or assumptions or provide additional information. If the entity does not comply, the accountant should withdraw from the engagement or report as described below. (See discussion of materiality, Section 700.06)

.05 The following circumstances result in an adverse report:

a. The accountant believes that the financial forecast departs from the presentation guidelines discussed in Section 400.[5]

b. The accountant believes one or more significant assumptions do not provide a reasonable basis for the forecast. (See Section 720.09.)

Departure From The Presentation Guidelines

.06 The omission of one or more items required for a minimum presentation of a financial forecast (described in Section 400.05) is not a departure from the presentation guidelines as contemplated by this section. A presentation with such an omission is a partial presentaton. Section 2000 discusses partial presentations and the accountant's services and reports with respect to them.

.07 If the presentation, including the summary of significant assumptions, fails to disclose assumptions that, at the time of presentation, appear to be significant, the accountant should describe the assumptions in his report.

.08 When the accountant has made a review in accordance with this guide and he believes that the financial forecast is materially affected by a departure from the presentation guidelines shown in Section 400, he should issue an adverse report.

Unreasonable Assumption(s)

.09 If the accountant believes one or more significant assumptions do not provide a reasonable basis for the presentation, he should issue an adverse report. A separate paragraph in the accountant's report should state the reasons for his conclusion, and the concluding paragraph should state that the accountant believes that the assumptions do not provide a reasonable basis for the financial forecast.

Form of Adverse Report

.10 The following is an example of an adverse review report on a financial forecast when the accountant believes a significant assumption is unreasonable.

> The accompanying forecasted balance sheet, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

5/ See also Section 2000, Partial Presentations.

We have reviewed the forecast in accordance with applicable guidelines for a review of a financial forecast established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

As discussed under the caption "Sales" in the summary of significant forecast assumptions, the forecasted sales include, among other things, revenue from the Company's federal defense contracts continuing at the current level. The Company's present federal defense contracts will expire in March 19XX. No new contracts have been signed and no negotiations are under way for new federal defense contracts. Furthermore, the federal government has entered into contracts with another company to supply the items being manufactured under the Company's present contracts.

Based on our review, we believe that the accompanying forecast is not presented in conformity with applicable guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants because management's assumptions, as discussed in the preceding paragraph, do not provide a reasonable basis for management's forecast.

Scope Limitation

.11 The accountant can issue an unqualified report only if the review has been conducted in accordance with this guide and he has been able to apply all the procedures he considers necessary in the circumstances. The scope of the accountant's review may be limited either (a) by client-imposed conditions that preclude the application of one or more procedures that the accountant considers necessary in the circumstances to comply with the guidelines set forth in this guide or (b) by circumstances, such as the accountant's inability to evaluate significant assumption(s) because they are not suitably supported. Limitations on the scope of the review, whether imposed by the client or by other circumstances, may require the accountant to state in his report that he cannot evaluate the presentation of the financial forecast or assess whether the assumptions provide a reasonable basis for the presentation.

.12 If the accountant does not believe an assumption(s) to be suitably supported, he should assess its effect on the interrelationships of assumptions and on the financial forecast taken as a whole.

.13 If the responsible party restricts the scope of the accountant's procedures or declines to develop the information the accountant considers necessary to evaluate one or more significant assumptions, the accountant generally should issue a report describing a scope limitation.

.14 The accountant's report should indicate in a separate paragraph(s) the respects in which the review did not comply with this guide. The accountant should state that the scope of the review was not sufficient to enable him to express a conclusion with respect to the presentation or the underlying assumptions, and the concluding paragraph should include a direct reference to the explanatory paragraph(s).

.15 The following is an example of a report on a review of a financial forecast for which a significant assumption could not be evaluated.

> The accompanying forecasted balance sheet, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX and for the year then ending, present, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.
>
> We have reviewed the forecast. Except as explained in the following paragraph, our review was made in accordance with applicable guidelines for a review of a financial forecast established by the American Institute of Certified Public Accountants and included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We have no responsibility to update this report for events and circumstances occurring after the date of this report.
>
> As discussed under the caption "Income From Investee" in the summary of significant forecast assumptions, the forecast includes income from an equity investee constituting 23 percent of forecasted net income, which is management's estimate of the income to be received from the investee for 19XX. The investee has not prepared a forecast for the year ending December 31, 19XX, and we were therefore unable to inspect suitable support for this assumption.
>
> Since, as described in the preceding paragraph, we are unable to evaluate management's assumption regarding income from an equity investee and other assumptions that depend thereon, we express no conclusion with respect to the presentation of or the assumptions underlying the accompanying forecast.

.16 When there is a scope limitation and the accountant also believes there are material departures from the presentation guidelines in Section 400, those departures should be described in the accountant's report.

Lack of Independence

.17 Whether or not the accountant is independent is something he must decide as a matter of professional judgment. When the accountant is not independent, he cannot perform a review in accordance with applicable guidelines. In that case, the accountant may perform a compilation of the prospective financial statements and report accordingly (see Section 600).

Evaluation Based in Part on Report of Another Accountant

.18 When more than one accountant is involved in the review, the guidance provided for that situation in examinations of historical financial statements is generally applicable. When the principal accountant decides to refer to the report of another accountant as a basis, in part, for his own report, he should disclose that fact in stating the scope of the review and should refer to the report of the other accountant in the concluding paragraph of the report. These references indicate division of responsibility for performance of the review.

Comparative Historical Financial Information

.19 A financial forecast may be included in a document that also contains historical financial statements and accountant's report thereon.6/ In addition, the historical financial statements that appear in the document may be summarized and presented with the financial forecast for comparative purposes.7/ An example of the reference to the accountant's report on the historical financial statements when he audited, reviewed, or compiled those statements is presented below:

(concluding sentence of first paragraph)

> ...The historical financial statements for the year ended December 31, 19XX, (from which the historical data is derived) and our report thereon are set forth on pages xx-xx of this document.

Emphasis of a Matter

.20 In some circumstances, the accountant may wish to emphasize a matter regarding the financial forecast but, nevertheless, intends to issue an unqualified report. Such information may be presented in a separate paragraph of the accountant's report.

Reporting When the Review is Part of a Larger Engagement

.21 The accountant's review of a financial forecast may be part of a larger engagement. Examples of such larger engagements are financial feasibility studies and business acquisition studies. It is often appropriate to expand the report on the review of the financial forecast to describe the entire engagement.

Financial Feasibility Studies

.22 A common type of larger engagement is the preparation of and report on a financial feasibility study. Preparation of a financial feasibility study generally includes such elements as the following:

- Analyzing program history, objectives, timing and financing
- Analyzing demand
- Assisting management to identify key factors on which future financial results will depend
- Assisting management to develop assumptions that form the basis for the financial forecast
- Assembling the financial forecast

6/ The accountant's responsibility with respect to those historical financial statements upon which he is not engaged to perform a professional service is described in SAS No. 26, in the case of public entities, and SSARS 1, in the case of nonpublic entities.

7/ SAS No. 42 discusses the accountant's report where summarized financial statements are derived from audited statements that are not included in the same document.

- o Reviewing the financial forecast, which permits expressing conclusions on whether (a) the assumptions provide a reasonable basis for the forecast and (b) the forecast is presented in conformity with applicable presentation guidelines

- o Concluding whether the financial forecast indicates that sufficient funds could be generated to meet operating and debt service requirements.

When the financial feasibility study includes such procedures, the accountant's report on the study often describes them and his conclusions.

.23 Following is a report that might be issued when an accountant chooses to expand his report on a financial feasibility study. Although the entity referred to in the report is a hospital, the form of report is applicable to other entities, such as a hotel or a stadium.

.24 Although the following report format and language should not be departed from in any significant way, the language used should be tailored to fit the circumstances that are unique to a particular engagement (for example, the description of the proposed capital improvement program, paragraph c; the proposed financing of the program, paragraphs b and d; the specific procedures applied by the accountant, paragraph e; and any explanatory comments included in emphasis-of-a-matter paragraphs, paragraph j, which deals with a general matter, and paragraph k, which deals with specific matters).

Expanded Report

a. The Board of Directors
Example Hospital
Example, Texas

b. We have prepared a financial feasibility study of the Example Hospital's plans to expand and renovate its facilities. The study was undertaken to evaluate the ability of the Example Hospital (the Hospital) to meet the Hospital's operating expenses, working capital needs, and other financial requirements, including the debt service requirements associated with the proposed $25,000,000 (legal title of bonds) issue, at an assumed average annual interest rate of 10.0 percent during the five years ending December 31, 19X6.

c. The proposed capital improvements program (the Program) consists of a new two-level addition which is to provide fifty additional medical-surgical beds, increasing the complement to 275 beds. In addition, various administrative and support service areas in the present facilities are to be remodeled. The Hospital administration anticipates that construction is to begin June 30, 19X2, and to be completed by December 31, 19X3.

d. The estimated total cost of the Program is approximately $30,000,000. It is assumed that the $25,000,000 of revenue bonds that the Example Hospital Finance

Authority proposes to issue would be the primary source of funds for the Program. The responsibility for payment of debt service on the bonds is solely that of the Hospital. Other necessary funds to finance the Program are assumed to be provided from Hospital funds, from a local fund drive, and from interest earned on funds held by the bond trustee during the construction period.

e. Our procedures included analysis of
   - o Program history, objectives, timing and financing
   - o The future demand for the Hospital's services, including consideration of

     Economic and demographic characteristics of the Hospital's defined service area.

     Locations, capacities and competitive information pertaining to other existing and planned area hospitals.

     Physician support for the Hospital and its programs.

     Historical utilization levels.
   - o Planning agency applications and approvals.
   - o Construction and equipment costs, debt service requirements, and estimated financing costs.
   - o Staffing patterns and other operating considerations.
   - o Third party reimbursement policy and history.
   - o Revenue/expense/volume relationships.

f. We also participated in gathering other information, assisted management in identifying and formulating its assumptions, and assembled the accompanying financial forecast based upon those assumptions.

g. The accompanying financial forecast for the annual periods ending December 31, 19X2 through 19X6, is based upon assumptions that were provided by or reviewed with and approved by management. The financial forecast includes:
   - o Balance sheets
   - o Statements of revenues and expenses
   - o Statements of changes in fund balance.

h. The financial forecast presents, to the best of management's knowledge, the Hospital's expected financial position, results of operations, and changes in financial position and fund balance for the forecast periods. Accordingly, the forecast reflects its judgment, based on present circumstances, of the expected set of conditions and its expected course of action.

i. We have made a review of the financial forecast in accordance with applicable guidelines for a review of a financial forecast established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast.

j. Legislation and regulations at all levels of government have affected and may continue to affect revenues and expenses of hospitals. The financial forecast is based upon legislation and regulations currently in effect. If future legislation or regulations related to hospital operations are enacted, such legislation or regulations could have a material effect on future operations.

k. The interest rate, principal payments, Program costs, and other financing assumptions are described in the section entitled "Summary of Significant Forecast Assumptions and Rationale." If actual interest rates, principal payments, and funding requirements are different from those assumed, the amount of the bond issue and debt service requirements would need to be adjusted accordingly from those indicated in the forecast. If such interest rates, principal payments, and funding requirements are lower than those assumed, then such adjustments would not adversely affect the forecast.

l. Our conclusions are presented below:

   o We believe that the accompanying financial forecast is presented in conformity with applicable guidelines for presentation of a financial forecast established by the American Institute of Certified Public Accountants.

   o We believe that the underlying assumptions provide a reasonable basis for management's forecast. However, some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast periods will vary from the forecast, and the variations may be material.

   o The accompanying financial forecast indicates that sufficient funds could be generated to meet the Hospital's operating expenses, working capital needs, and other financial requirements, including the debt service requirements associated with the proposed $25,000,000 bond issue, during the forecast periods. However, the achievement of any financial forecast is dependent upon future events, the occurrence of which cannot be assured.

m. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

n. (Date)

Section 730 Considerations for the Accountant Reporting on a Review of Financial Forecasts Contained in Public Offering Statements

.01 This section discusses some aspects of the accountant's services with regard to financial forecasts when the statements are included in public offering statements. Public offering statements include registrations under the Securities Act of 1933 as well as certain non-SEC offerings such as private placement memorandums and tax-exempt bond offerings.1/

Procedures Between the Date of the Accountant's Report and Effective Date in 1933 Act Filings

.02 A registration statement filed under the Securities Act of 1933 speaks as of its effective date, and the statutory responsibility of an accountant whose report is included in such a registration statement may be determined in the light of the circumstances as of such date. This aspect of an independent accountant's responsibility is peculiar to registration statements filed with the SEC.

.03 Unlike audited historical financial statements, financial forecasts, if prepared even a few weeks later, may well vary in some respects from earlier versions. Therefore, as provided in Section 720, the report on a review of a financial forecast should indicate that the accountant has no responsibility to update his report for events and circumstances occurring after the date of his report. Nevertheless, the accountant should have a reasonable basis to consent to the use of his report in a 1933 Act registration statement as of the consent2/ date.

.04 To have a reasonable basis to consent to the use of his report on the review of a financial forecast in the registration statement, the accountant should perform procedures with respect to the period from the date of his review report up to the consent date as close to the effective date as is reasonable and practicable in the circumstances. The accountant generally should:

a. Read the latest available interim financial statements, operating reports, and any relevant prospective information such as budgets; consider the prospective results in relation to the actual results achieved in the interim period; and inquire whether the accounting principles used in the preparation of such information are consistent with the principles used in preparing the forecast.

b. Read the entire prospectus and other pertinent portions of the registration statement and consider that information in relation to the prospective results and the summary of significant assumptions.

1/ These are categorized as general offerings of debt or equity in Section 210.

2/ Regulation S-K (Section 229.10 (b) (1)) states that in the case of a registration statements under the 1933 Act a "reviewer (of a financial forecast) would be deemed an expert and an appropriate consent must be filed with the registration statement."

c. Inquire of and obtain written representations from the responsible party, including those individuals responsible for matters significant to the financial forecast, as to whether there are any events, plans, or expectations (whether or not reflected or disclosed in the registration statement) that, in its opinion, may require the financial forecast to be modified, or that should be disclosed, in order that the forecast reflect the responsible party's judgment based on present circumstances of the expected set of conditions and its expected course of action. In lieu of obtaining an additional representation letter at the consent date, the accountant may have the responsible party update the representation letter originally signed at the report date.

d. Read the available minutes of meetings of the board of directors and related committees. As to meetings for which minutes are not available, inquire about matters dealt with at such meetings.

e. Make such additional inquiries or perform such procedures as he considers necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures.

.05 If, as a result of the above procedures, the accountant believes that the forecast, including the summary of significant assumptions, should be revised, he should request his client to revise its forecast and, if engaged to do so, review the revised forecast. If the client does not make appropriate revision to the forecast, the accountant should not consent to the use of his report in the registration statement.

The Accountant's Consent

.06 In registration statements filed with the SEC under the Securities Act of 1933, as in other types of offering materials, the accountant's consent to the use of his report and to references to him in the offering materials must be in writing. In addition, the accountant's consent for a 1933 Act filing should be manually signed and dated.

.07 Because a registration statement under the 1933 Act speaks as of its effective date, the accountant's consent should be dated at or near the effective date of the registration statement. The dating of the consent at the effective date, however, as discussed in section 730.03 does not constitute an update of the accountant's report.

.08 The following is an example of the accountant's consent to the use of his report in an offering statement:

> We hereby consent to the use of our report dated November 15, 19X3 on our review of the financial forecast of XYZ Company and the use of our name, and the references to our firm appearing under the headings __________ and __________ in the registration statement. It should be noted that, as indicated in our report, we have no responsibility, under the applicable guidelines for review of a financial forecast established by the American Institute of Certified Public Accountants, to update our report for events and circumstances occurring after the date of the report, and consequently we have not updated our report.

Experts Section of 1933 Act Filings

.09 The experts section of the registration statement should be so worded that there is no implication that the forecast has been prepared by the accountant or that the forecast is not the direct responsibility of the responsible party. The following is an example of a reference to the accountant in the experts section:3/

> The financial forecast on pages _____ to _____ of this prospectus has been reviewed by _____________ independent public accountants and is included herein in reliance on the authority of that firm as experts in reporting on reviews of financial forecasts.

Comfort Letters

.10 No description of the additional procedures or any form of assurance based on those procedures should be included in the report on the forecast or in any document that includes the report. Further, no such description or assurance should be contained in a letter to underwriters ("comfort letter") or others.

3/ The designation of the accountant as an "expert" is a concept that appears in section 11 of the 1933 Act. Therefore, the term as defined is generally applicable only to filings under the 1933 Act and not applicable to filings not made under that act.

GUIDANCE REGARDING FINANCIAL PROJECTIONS

Section 1000 Introduction to Guidance Regarding Financial Projections

.01 This section of the guide is designed for entities that present financial projections[1] and accountants who provide professional services with respect to such projections.

02. Sections 300-730 of this guide are primarily concerned with financial forecasts, although the guidance in those sections is also generally applicable to financial projections. Some of the guidance in those sections should, however, be modified because of the presence of hypothetical assumption(s) in a financial projection. Thus, the guidance in the preceding sections should be considered in the context of hypothetical assumptions.

.03 The sections in this part of the guide explain how the preceding sections should be modified for financial projections. The sections which follow are numbered 1300-1730 to correspond with the preceding sections numbered 300-730. For example, section 1400 should be read in conjunction with section 400 for presentation of financial projections, and section 1620 should be read in conjunction with section 620 for reporting on compilations of financial projections.

1/A financial projection is a prospective presentation that incorporates one or more hypothetical assumptions (see section 200.04). Such a presentation, except as used in a multiple projection, is not intended for use in conjunction with general offerings of debt or equity.

Section 1300. Preparation of Financial Projections

Introduction

.01 Section 300, Preparation of Financial Forecasts, describes guidelines for a process to prepare financial forecasts. While the guidelines are primarily concerned with financial forecasts, they are also applicable, as modified by this section, to financial projections. Modifications to individual sections are discussed below.

Good Faith (section 310.02)

1310.01 While a financial forecast prepared in good faith is neither unduly optimistic nor pessimistic, the purpose of a financial projection may require such optimism or pessimism. For example, a breakeven analysis may be prepared by a real estate developer who expects to realize income. Accordingly, the hypothetical assumption used in a financial projection should be consistent with the purpose of the projection, and the other assumptions, including assumed courses of action, should be consistent with events expected to occur given the hypothetical assumptions.

Appropriate Accounting Principles (section 312.04)

1312.01 There are instances in which changes in accounting principles reflected in financial projections need not be expected to occur in the historical financial statements. For example, a projection may be prepared for the purpose of estimating an entity's financial results based on a change in the method by which inventories are valued. These may be prepared for analytical purposes with no intention of actually changing the method of inventory valuation.

.02 However, a change in accounting principle should be reflected in a multiple projection used in a general offering of debt or equity only if the responsible party expects to make the change in its historical financial statements.

Best Information (section 313)

1313.01 While the guideline regarding best information applies to financial projections, it need not be applied to hypothetical assumptions selected to analyze alternative courses of action. However, the assumptions other than the hypothetical ones should be developed by the responsible party using the best information reasonably available at the time, given the hypothetical assumptions. For example, a financial projection might show results using several sales prices for the entity's product. The assumptions relating to semivariable costs (e.g., commissions) should be developed based on the best information reasonably available for each sales price and should be consistent with the expected course of action at each sales price.

.02 In a multiple projection, the hypothetical assumptions are used to estimate expected results, not to analyze alternative courses of action. Accordingly, the hypothetical assumptions should be developed using the best information reasonably available at the time.

Consistent with Plans (section 314)

1314.01 Financial projections may not necessarily be consistent with the plans of the responsible party but instead may represent alternatives based on a special purpose contemplated in preparing the presentation. The alternatives should reflect the responsible party's expected actions given the actual occurrence of the hypothetical event. For example, a manufacturing company that does not lay off workers during slow periods should not treat labor as a variable expense if the hypothetical event is a temporary reduction in production levels. The presentation should reflect the course of action consistent with its purpose.

.02 Accordingly, the information used in preparing financial projections should be consistent with the plans of, or alternatives being analyzed by, the entity.

Appropriate Assumptions (section 316.03)
1316.01 Hypothetical assumptions need not be reasonable but should be appropriate in light of the purpose for which the financial projection is prepared. All other assumptions should be reasonable given the hypothetical assumptions. That is, the other assumptions should be developed to depict conditions based on the hypothetical assumptions. For example, if a financial projection is prepared to show the effect of the construction of a new production facility that is partially financed, the presentation should include the effect of the related debt service.

.02 Hypothetical assumptions need not be supported as they relate to the special purpose of the presentation. The other assumptions, however, should be suitably supported given the hypothetical assumption.

.03 A multiple projection may be used in general offerings of debt or equity because the responsible party is unable to make a single point estimate of financial position, results of operations, and changes in financial position for the prospective period. Thus, the hypothetical assumptions in such a multiple projection are not expected nor supported to the same extent as assumptions underlying a forecast. Nevertheless, management should suitably support that the hypothetical assumptions encompass a range within which the expected result for those assumptions will fall.

Section 1400. Presentation of Financial Projections

Introduction
.01 Section 400, Presentation of Financial Forecasts, describes presentation guidelines for financial forecasts. While the guidelines are primarily concerned with financial forecasts, they are also applicable, as modified by this section, to financial projections. Modifications to individual sections are discussed below.

Titles (section 400.02)
.02 Statement titles in financial projections should be descriptive of the presentation. Accordingly, they should not imply that the presentation is a forecast. In addition, titles should refer to any significant hypothetical assumptions. For example, a break even analysis might be titled "Projected Results of Operations and Changes in Financial Position at Break Even Sales Volume."

Accounting Principles (section 400.09)
.03 Although ordinarily a financial projection should use the accounting principles expected to be used in the historical statements, sometimes the special purpose of the presentation requires it to be prepared based on other accounting principles. In such cases the use of different accounting principles should be disclosed. Differences in financial position and results of operations resulting from the use of different accounting principles may be reconciled and disclosed. An example of such a disclosure follows.

> The projection assumes that inventory will be valued on the last-in, first-out method whereas the company has historically used the first-in, first-out method. If the latter method were used in this projection, inventory and income before income taxes would be increased by $XX, provision for income taxes would be increased and other working capital decreased by $XX, and net income and shareholders' equity would be increased by $XX.

.04 However, a multiple projection used in general offerings of debt or equity should use the accounting principles expected to be used in the historical financial statements.

Presentation of Amounts (section 400.14)
.05 Presenting a multiple projection is not the same as presenting a financial forecast solely in terms of ranges as discussed in section 400.14, because a multiple projection consists of two or more presentations expressed as single point estimates. Nevertheless, the presentation of a multiple projection should not imply that (a) the projections at the extremes represent the best and the worst possible results or (b) the extremes were calculated based on a scientifically determined interval.

Disclosure of Assumptions (sections 400.17 and .24)
.06 In addition to those assumptions discussed in section 400.19, the responsible party should identify which assumptions are hypothetical. In addition, the disclosure should indicate if the hypothetical assumptions are improbable.

.07 The introduction to the summary of significant assumptions should clearly explain any special purpose and limitation of the usefulness of the statements. For example, the introduction preceding the summary of assumptions for a presentation of results with sales at a maximum productive capacity would be similiar to the following. This example illustrates the introduction for a presentation with an improbable hypothetical assumption; the example should be modified as appropriate in the circumstances.

> This financial projection for sales volume at maximum productive capacity presents, to the best of management's 1/ knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period if such sales volume were attained. Accordingly, the projection reflects its judgment, based on present circumstances, of the expected set of conditions and its expected course of action if such sales volume were experienced. The presentation is designed to provide information to the Company's board of directors concerning the maximum profitability that might be achieved if current capacity were expanded through the addition of a third production shift and should not be considered to be a presentation of expected future results. Accordingly, this projection may not be useful for other purposes. The assumptions disclosed herein are those that management believes are significant to the projection; however, management considers it highly unlikely that the stated sales volume will be experienced during the projection period. Even if the stated sales volume were attained, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to (date), the date of this projection; therefore, the actual results achieved during the projection period will vary from the projection and the variations may be material.

.08 The introduction for a presentation of a multiple projection would ordinarily need no reference to limitations on usefulness because such a presentation would be appropriate for general use. The following is an example of an introduction in which the responsible party could not make a point estimate of occupancy of its apartment building but expects that actual occupancy will be between 60 and 80 percent of available apartments:

> These financial projections at occupancy rates of 60% and 80% of available apartments present, to the best of management's1/ knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period at each occupancy rate. Accordingly, the projections reflect its judgment, based on present circumstances, of the expected conditions and its expected course of action at each occupancy rate. The assumptions disclosed herein are those that management believes are significant to the projections. Management expects that the actual occupancy rate achieved will be within the range shown, however there can be no assurance that it will. Even if the actual occupancy rate attained is within the range shown, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to (date), the date of these projections; therefore, the actual results achieved during the projection period may vary materially outside the range presented by the projections.

Illustrative Financial Projection

.09 An illustrative financial projection appears in section 1410.

1/If the responsible party is other than management, this reference should be to that third party who assumes responsibility for the assumptions.

Section 1410 Illustrative Financial Projection

Introduction

.01 This section illustrates a financial projection. The example shown is a cash flow projection that assumes the construction of a plant. Because of the hypothetical assumption (the construction of the plant), the presentation can be expected to be useful only to the responsible party and third parties with whom the entity is dealing directly in regard to the plant construction.

ABC Company, Inc.

Statement of Projected Results of Operations and Cash Flow Assuming Construction of an Additional Plant

for the Five Years Ending December 31, 19X7
(in thousands except per share amounts)

	YEAR ENDING DECEMBER 31,				
	19X3	19X4	19X5	19X6	19X7
Net Sales	$ 101,200	$ 112,300	$ 142,000	$ 156,200	$ 173,400
Cost of Sales	77,500	86,100	109,300	120,100	133,300
Gross profit	23,700	26,200	32,700	36,100	40,100
Selling, General, and Administrative expenses	15,100	16,500	19,500	21,400	23,400
Operating income	8,600	9,700	13,200	14,700	16,700
Other income (deductions)					
Miscellaneous	1,700	1,200	1,000	1,300	1,800
Interest expense	(2,400)	(3,500)	(3,400)	(3,200)	(3,000)
	(700)	(2,300)	(2,400)	(1,900)	(1,200)
Income before taxes	7,900	7,400	10,800	12,800	15,500
Income taxes	3,400	2,800	4,700	5,500	6,700
Net income	4,500	4,600	6,100	7,300	8,800
Add non-cash expenses:					
Depreciation and amortization	2,800	2,800	3,400	3,500	3,500
Deferred taxes	500	450	550	600	650
	7,800	7,850	10,050	11,400	12,950
Add (deduct):					
Loan proceeds for additional plant facility	8,500	1,500	-	-	-
Increase in excess of receivables and other assets over payables	(1,000)	(1,000)	(2,000)	(3,000)	(3,500)
Cash requirements for building costs	(8,200)	(1,800)	-	-	-
Other additions to plant and equipment	(3,400)	(2,200)	(2,200)	(2,200)	(2,200)
Cash requirements for repayment of debt	(2,600)	(2,600)	(3,700)	(3,500)	(3,500)
Dividends	(1,400)	(1,400)	(1,900)	(2,200)	(2,700)
Increase (decrease) in cash	(300)	350	250	500	1,050
Cash beginning of year	3,300	3,000	3,350	3,600	4,100
Cash end of year	$ 3,000	$ 3,350	$ 3,600	$ 4,100	$ 5,150
Earnings per share	$ 4.80	$ 4.92	$ 6.51	$ 7.79	$ 9.39
Dividends per share	$ 1.50	$ 1.50	$ 2.03	$ 2.35	$ 2.88

See Accompanying Summary of Significant Assumptions and Accounting Policies.

ABC Company, Inc.

Summary of Significant Assumptions Employed in Preparation of the Statement of Projected Results of Operations and Cash Flow Assuming Construction of an Additional Plant for the Five Years Ending December 31, 19X7

This financial projection of operations and cash flow assuming construction of an additional plant presents, to the best of management's knowledge, the expected results of operations, changes in financial position and cash flow for the projection period if a plant were constructed to increase production capacity by approximately 20 percent. Accordingly, the projection reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action if such a plant were constructed. The presentation is designed to provide information for potential bank financing of the construction of the additional plant and cannot be considered to be a presentation of expected future results. Accordingly, this projection may not be useful for other purposes. The assumptions disclosed herein are those that management believes are significant to the projection, however management has not decided that it will construct such a plant. Even if the plant were constructed, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur subsequent to October 24, 19X2, the date of this projection; therefore the actual results achieved during the projection period will vary from the projection and the variations may be material.

a. **Summary of Significant Accounting Policies.** (not illustrated)

b. **Stipulated Assumption - Increase in Production Capacity by Construction of a New Plant.** The projection is based on the assumption that production capacity will be increased by approximately 20% by the construction of a 160,000 square foot production facility in Richmond, Virginia.

   Construction on the new plant is projected to begin in February, 19X3 and be completed by June 30, 19X4 at a total cost of $10,000,000 including construction period interest of $1,300,000. Production cost estimates and the projected completion date have been taken from competitive bids received.

   The decision to proceed with the project and awarding of contracts will depend on the completion of financing arrangements.

c. **Sales.** The overall market for the Company's products has grown over the past five years at an average rate of 2 percent above the actual increase in gross national product, and the Company's market share has remained steady at 14 to 16 percent. Based upon a recent market study of demand for the Company's products, sales are projected to increase 11 percent per annum from 19X2 to 19X4 (which is consistent with a 2 percent above the Department of Commerce Bureau of Economic Analysis estimate of the rise in gross national product in the projection period), with a market share of 15 percent and unit prices increased to cover projected increased cost of manufacturing. Based upon the study, an additional 15 percent increase in sales is projected to occur beginning in 19X5 and will be met by the added capacity resulting from the plant expansion.

d. **Cost of Sales**

Materials. Materials used by the Company are expected to be readily available, and the Company has generally used producer associations' estimates of prices in the projection period to project material costs. The Company expects to be able to assure sufficient supplies and estimates that the cost of materials will increase by 12 percent over 19X2.

Labor. The Company's labor union contract, which covers substantially all manufacturing personnel, will be subject to renegotiation in 19X6. Labor costs until that time are projected based on the existing contract. For 19X7 labor costs, including fringe benefits, are projected to increase 19 percent per year above the 19X6 level. The outcome of the projection is particularly sensitive to variances in such labor costs. For each percentage point variance from the projected increase, net income and cash will vary by approximately $380,000.

e. **Plant and Equipment and Depreciation Expense.** Projected additions to plant and equipment other than the planned plant expansion, comprise principally the regular periodic replacement of manufacturing plant and vehicles at supplier's quoted estimated prices and do not involve any significant change in manufacturing capacity or processes. Depreciation is projected on an item-by-item basis. Depreciation on the new facility is projected on a straight line basis over 20 years.

f. **Selling, General, and Administrative Expenses.** The principal types of expense within this category are salaries, transportation costs, and sales promotion. Salaries are projected on an individual-by-individual basis, using expected salary rates in the projection period. Pension cost is planned to be funded and is projected based upon its direct relationship to payroll cost. Transportation costs comprise principally the use of contract carriers; volume is projected based upon the sales and inventory projections and rates are forecasted to rise by 16 percent per year based upon trucking industry forecasts. Sales promotion costs are expected to increase in line with the consumer price index as is the level of other expenses.

g. **Bank Borrowings and Interest Expense.** The projection assumes that the Company will obtain an extension of existing short-term lines of credit at terms comparable to those in effect in 19X2 (2 percent over prime rate). The Company used the arithmetic mean of (three widely used estimates) bank prime rate during the projection period (ranging from 12 percent to 14 percent) to estimate prime rate at 13 percent. The Company projects additional long-term borrowings of $10 million to finance the planned plant expansion (including $1,300,000 of construction period capitalized interest) and has entered into preliminary negotiations with its bankers for this financing. Based upon the preliminary negotiations, the Company has assumed that the additional long-term financing will bear interest at 14 percent.

h. **Miscellaneous Income.** The projection assumes royalty income of $950,000 will be received annually based on an agreement under which the Company is to receive a minimum of $950,000 for the first 10,000,000 units produced under its patented die casting process and $.05/unit above that level. Management believes it is unlikely that production will exceed 10,000,000 units in any of the projection periods.

i. **Income taxes.** The provision for income taxes is computed using the statutory rates in effect during 19X2, which are not expected to change. The Company anticipates that it will take investment tax credits on the machinery and equipment to be installed in the new plant when the plant is placed in service in 19X4.

j. **Dividend.** The Company's normal dividend policy is to pay out the previous year's dividend increased to the extent of at least one-third of any increase in profits over the previous year, provided the board of directors considers that the Company's cash and working-capital position will not be adversely affected.

Section 1500 The Accountant's Services With Respect to Financial Projections

.01 Section 500, The Accountant's Services with Respect to Financial Forecasts, describes guidelines for an accountant's services with respect to financial forecasts. While those guidelines are primarily concerned with financial forecasts, they are also applicable, as modified by this section, to an accountant's services on financial projections.

Association (sections 500.01-.06)
.02 There are some considerations in addition to those discussed in sections 500.01-.06 for an accountant's association with financial projections. The additional considerations are discussed below.

.03 The accountant should not be associated with a financial projection that excludes identification of the hypothetical assumptions or description of the limitations of the usefulness of the presentation. However, as stated in section 1400.08, there is no limitation on the usefulness of a multiple projection.

.04 It would be inappropriate to distribute a financial projection generally to solicit debt or equity financing (except where the presentation supplements a financial forecast or a multiple projection). Accordingly, the accountant would find it inappropriate to be associated with a financial projection that he believes will be used in that manner.

.05 Similarly, the accountant may deem in inappropriate to be associated with projections that would be misleading, for example, a multiple projection in which there is not a reasonable expectation that the actual results will fall within the range of the hypothetical assumptions presented.

Susceptibility to Review (sections 500.08-.09)
.06 In determing whether a financial projection is susceptible to review, the accountant should, except as stated below, follow the guidance in sections 500.08-09.

.07 Certain financial projections are reviewable, despite the lack of support for the hypothetical assumptions. The accountant need not consider support for the hypothetical assumptions to determine the presentation's susceptibility to review. The level of support for other assumptions sufficient to enable an accountant to review a financial projection would consist of those items in sections 500.08 and .09. However, as the number and significance of the hypothetical assumptions increases, the accountant may not be able to satisfy himself about the presentation as a whole by obtaining support for the remaining assumptions.

.08 For a multiple projection for use in a general offering of debt of equity to be reviewable, there should be suitable support that the hypothetical assumptions encompass a range within which the expected result for those assumptions will fall.

Other Information in a Client-Prepared Document
Containing Financial Projections (section 500.15)
.09 The examples of inconsistent information given in section 500.15 would not necessarily be inconsistent in a document containing a financial projection (for example a hypothetical assumption may be unlikely to occur). Although the examples may not apply, the accountant should use his judgment in determining whether a remark in the document is inconsistent with the presentation (see section 500.14).

Section 1600 Procedures for a Compilation of Financial Projections

.01 The guidelines for performance of a compilation as discussed in section 600, Procedures for a Compilation of Financial Forecasts, are generally applicable to a compilation of financial projections. However, this section demonstrates how that guidance would be modified for a compilation of a financial projection.

Background (section 600.05)
.02 In performing compilations of financial projections, the accountant should be familiar with the guidelines for preparation and presentation of projections. These guidelines are found in sections 300 (as modified by section 1300) and 400 (as modified by section 1400) of this guide.

Compilation Procedures (section 600.10)
.03 A financial projection does not purport to present expected financial position, results of operations, and changes in financial position for the prospective period, but presents prospective financial statements based on a hypothetical assumption. Accordingly, the accountant should consider whether:

(a) the assumption (section 600.10(f)), and

(b) the statements (section 600.10(h)(ii)(b))

appear to be obviously inappropriate in relation to the special purpose of the presentation.

.04 A multiple projection is a presentation of two or more financial projections in which the hypothetical assumptions form a range within which the actual results for those assumptions are expected to fall. Thus, the accountant should consider whether the assumptions (section 600.10(f)) and the statements (section 600.10(h)(ii)(b)) are obviously inappropriate in relation to the hypothetical assumptions and whether the multiple projection, taken as a whole, appears to be obviously inappropriate in relation to the expected conditions and course of action in the prospective period.

.05 The accountant should confirm his understanding of the financial projection (including assumptions) by obtaining written representations from the responsible party. Since the amounts reflected in the financial projections are not supported by historical books and records but by assumptions, the accountant should obtain representations in which the responsible party indicates its responsibility for the assumptions. The representations should be signed by the responsible party at the highest level of authority whom the accountant believes is responsible for and knowledgeable, directly or though others, about matters covered by the representations. The representations should include a description of the special purpose and any limitations on the usefulness of the presentation for a single projection, or include a statement that the responsible party expects the actual results for the hypothetical assumptions will fall within the range presented in a multiple projection. The responsible party should state that the assumptions are appropriate and indicate if the hypothetical assumptions are improbable, as discussed in section 1400.05.

Section 1610 Illustrative Engagement and Representation Letters

.01 The following is a sample excerpt from an engagement letter on a compilation of a financial projection. The letter would be modified as appropriate.

> This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.
>
> We will compile, in accordance with applicable guidelines established by the American Institute of Certified Public Accountants, from information mangement[1/] provides, the projected balance sheet(s) and related statements of income, retained earnings, changes in financial position and summaries of significant assumptions and accounting policies of the XYZ Company as of December 31, 19XX and for the year then ending. We will not express any form of assurance on the achievability of the projection(s) or reasonableness of the underlying assumptions.
>
> A compilation of prospective financial statements involves assembling prospective financial statments based on management's assumptions and performing certain other procedures with respect to the statements without evaluating the support for, or expressing a conclusion or any other form of assurance on the assumptions underlying such statements. If for any reason we are unable to complete our compilation of your prospective financial statements, we will not issue a report on such statements as a result of this engagement.
>
> The (multiple) financial projection presents, to the best of management's knowledge, the Company's expected financial position(s), results of operations and changes in financial position for the projected period based on (describe hypothetical assumptions). It is based on management's assumptions reflecting conditions it expects would exist and courses of action it expects would be taken, given (describe hypothetical assumptions).
>
> Management is responsible for representations about its plans and expectations and for disclosure of significant information that might affect the ultimate realization of the projected results.
>
> Even if (describe hypothetical assumptions) were to occur, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period will vary from the projection and the variations may be material. Our report will contain a statement to that effect.
>
> We have no responsibility to update our report for events and circumstances occuring after the date of such report.

1/ If the responsible party is other than management, the references to management should be replaced with the name of the third party who assumes responsibility for the assumptions.

At the conclusion of the engagement management agrees to supply us with a representation letter which, among other things, will confirm management's responsibility for the underlying assumptions and appropriateness of the prospective financial statements and their presentation.2/

In order for us to complete this engagement management must provide assumptions that are appropriate to the (multiple) projection. If the assumptions provided are inappropriate and have not been revised to our satisfaction, we will be unable to complete the engagement and, accordingly, we will not issue a report on the (multiple) projection.

.02 The following is an illustrative representation letter for an engagement to compile a financial projection. The written representations to be obtained should be based on the circumstances.

Date of Accountant's report

To Accountant

In connection with your compilation of the projected balance sheet(s) and related statements of income, retained earnings, and changes in financial position and summaries of significant assumptions if (describe hypothetical assumptions) and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, we make the following representations:

1. The (multiple) financial projection presents our assumptions and, to the best of our knowledge, the Company's expected financial position(s), results of operations and changes in financial position for the projection period assuming (describe hypothetical assumptions).

2. The accounting principles used in the (multiple) financial projection are (consistent with (the special purpose of the projection))3/ (in accordance with the generally accepted accounting principles expected to be used by the Company during the projection period, which are consistent with the principles that XYZ Company uses in preparing its historical financial statements).

3. The (multiple) financial projection is based on our judgment, considering present circumstances, of the expected conditions and our expected course of action if (describe hypothetical assumptions).

4. We have made available to you all significant information that we believe is relevant to the (multiple) financial projection.

2/ See footnote 2, section 610.02

3/ This alternative wording would not be appropriate for a multiple projection.

5. We believe that the assumptions underlying the (multiple) projection are appropriate and reasonable given the (describe hypothetical assumptions).

6. To the best of our knowledge and belief, the documents and records supporting the assumptions are appropriate.

7. We believe the projected results are achievable if (describe hypothetical assumptions) were to occur; however, the projection could be favorably or unfavorably affected by many unforeseeable and uncontrollable factors.

8. We intend to use this projection for (describe intended limited use).4/

(Signatures)

4/ For a compilation of a multiple projection, the following representation would be substituted: "We believe, to the best of our knowledge, that the actual (describe hypothetical assumptions) achieved will fall within the range presented; for those assumptions however there can be no assurance that it will. Even if the actual (describe hypothetical assumptions) achieved falls within the range presented for those assumptions, the multiple projection could be favorably or unfavorably affected by many unforseeable and uncontrollable factors."

Section 1620 The Accountant's Report on Compiled Financial Projections

.01 This section discusses how the guidance in section 620, The Accountant's Report on Compiled Financial Forecasts, would be modified for compilations of financial projections.

Elements of the Standard Report (section 620.01)
.02 In addition to the elements of the accountant's standard compilation report listed in section 620.01, a report on a compiled financial projection should include a description of the limitations on the usefulness of the presentation. However, because there is a reasonable expectation that the actual result will fall within the range of the hypothetical assumptions presented in a multiple projection, it is not necessary to describe any limitations as to the usefulness of such a presentation in the accountant's compilation report.

Standard Accountant's Reports
.03 The following is the form of the standard report for the compilation of a financial projection[1/]:

> The accompanying projected balance sheet, [2/] statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's[3/] knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period (describe or refer to hypothetical assumption, e.g., "that would result from operating at maximum productive capacity, as disclosed in items b and c of the summary of significant assumptions,") and is not intended to represent an estimate of future financial results. Accordingly, the financial projection reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action (describe hypothetical asumption, e.g., "if such sales

1 This form of report is appropriate whether the presentation is based on generally accepted accounting principles or an other comprehensive basis of accounting.

2/ When the presentation is summarized as discussed in section 400.03 this sentence might read "The accompanying financial projection of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and accounting policies, presents, to the best of management's knowledge, a summary of the expected results of operations and changes in financial position for the projection period (describe or refer to hypothetical assumption, e.g., 'that would result from operating at maximum productive capacity, as disclosed in items b and c of the summary of significant assumptions,') and is not intended to represent an estimate of future financial results."

3/ When the responsible party is other than management, the references to management in the standard report should be changed to refer to that third party who assumes responsibility for the assumptions.

volume were achieved"). However, even if the (hypothetical assumption, e.g., "sales volume were attained") some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period will vary from the projection, and the variations may be material.

We have compiled the projection in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a projection does not include evaluation of the support for the assumptions underlying the projection. Because a compilation of a projection is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

The accompanying projection and this report were prepared for (state special purpose, e.g., "presentation to the Board of Directors of XYZ Company for its considerations as to whether to add a third operating shift") and should not be relied on for any other purpose.

.04 The following is the form of the standard report on a compilation of a multiple projection[4/]:

The accompanying projected balance sheets,[5/] statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's[6/] knowledge, the Company's expected financial positions, results of operations, and changes in financial position for the projection period (describe or refer to hypothetical assumptions, e.g., "predicated on occupancy rates of 60% and 80% of available apartments, as disclosed in items b and c of the summary of significant assumptions"). Accordingly, the financial projections reflect its judgment, based on present circumstances, of the expected conditions and its expected course of action (describe hypothetical assumptions, e.g., "at each occupancy rate"). Management expects, to the best of its knowledge, that the actual (hypothetical assumption, e.g., "occupancy rate") achieved will be within the range shown; however, there can be no assurance that it will. However, even if the actual (hypothetical assumption, e.g., "occupancy rate") attained is within the range shown, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur. Therefore, the actual results achieved during the projection period may vary materially outside the range presented by the projections.

4/ This form of report is appropriate whether the presentation is based on generally accepted accounting principles or an other comprehensive basis of accounting.

5/ When the presentation is summarized as discussed in section 400.03 this sentence might read "The accompanying financial projections of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and accounting policies, present, to the best of management's knowledge, summaries of the expected results of operations and changes in financial position for the projection period (describe or refer to hypothetical assumption, e.g., 'predicated on occupancy rates of 60% and 80% of available apartments, as disclosed in items b and c of the summary of significant assumptions')."

6/ When the responsible party is other than management, the references to management in the standard report should be changed to refer to that third party who assumes responsibility for the assumptions.

We have compiled the projections in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a financial projection does not include evaluation of the support for the assumptions underlying the projection. Because a compilation of a financial projection is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Section 1700 — Procedures for a Review of Financial Projections

.01 This section demonstrates how section 700, Procedures for a Review of Financial Forecasts, would be modified for reviews of financial projections.

.02 Because of the nature of financial projections, the accountant's independent review of such statements is somewhat different than it is for financial forecasts. The accountant's procedures and reporting on reviews of financial projections differ primarily because they are concerned with the support for assumptions given the occurrence of the hypothetical assumptions and the presentation of the prospective financial statements for conformity with the presentation guidelines in section 400, as modified by section 1400.

.03 As a result of his review the accountant has a basis for reporting on whether a financial projection is presented in conformity with AICPA guidelines and whether the assumptions provide a reasonable basis for the responsible party's presentation given the hypothetical assumptions. Accordingly, the guidelines for a review (section 700.05 (g)) would be so modified for a review of a financial projection.

Procedures to Evaluate Assumptions (section 700.16)

.04 The accountant should perform those procedures he considers necessary in the circumstances to report on whether the assumptions provide a reasonable basis for the financial projection given the hypothetical assumptions. The accountant can conclude that the assumptions provide a reasonable basis for the financial projection given the hypothetical assumptions if the responsible party represents that the presentation reflects expected financial position, results of operations, and changes in financial position for the prospective period given the hypothetical assumptions and he concludes based on his review (1) that the responsible party has explicitly identified all factors that would materially affect the operations of the entity during the prospective period if the hypothetical assumptions were to materialize and has developed appropriate assumptions with respect to such factors and (2) that the other assumptions are suitably supported given the hypothetical assumptions.

Support for Assumptions (section 700.20)

.05 Except in the case of a multiple projection, the accountant need not obtain support for hypothetical assumptions, although he should consider whether they are consistent with the purpose of the presentation. If the accountant reviews a multiple projection, he should obtain suitable support for the responsible party's assertion that the expected results for the hypothetical assumptions will fall within the range of the hypothetical assumptions presented.

.06 In evaluating support for assumptions other than hypothetical assumptions, the accountant can conclude that they are suitably supported if the preponderance of information supports each significant assumption given the hypothetical assumptions. The accountant can conclude that there is suitable support for the hypothetical assumptions in a multiple projection if the preponderance of information supports an amount within the range of the hypothetical assumptions presented. (see section 700.21)

Procedures to Evaluate Preparation and Presentation of the Financial Projection (section 700.29)
.07 The accounting principles used in a financial projection need not be those expected to be used in the historical financial statements for the prospective period if use of different principles is consistent with the purpose of the presentation (see section 1400.03).1/ Therefore, rather than the objective shown in section 700.29(d), the accountant should perform procedures to provide reasonable assurance that:

> Accounting principles used in the financial projection are consistent with the accounting principles expected to be used in the prospective period and those used in the most recent financial statements, if any, or are consistent with the purpose of the presentation. (Although a different basis of accounting may be used in the projection than is expected to be used in the historical financial statements, see section 400.11).

Written Representations(section 700.32)
.08 The written representations that the accountant obtains should include a statement that the financial projection presents, to the best of the responsible party's knowledge, the expected financial position, results of operations, and changes in financial position given the hypothetical assumptions and reflects its judgment, based on present circumstances, of expected conditions and its expected course of action given the occurrence of the hypothetical events. The representations should also identify the hypothetical assumptions.

Illustrative Review Procedures (sections 700.41-.42)
.09 The illustrative review procedures shown in sections 700.40-.42 are applicable to reviews of financial projections. However, the illustrative procedures for reviews of financial projections other than a multiple projection should be modified as shown below:

- o The procedures shown in 700.41(b) would be applicable to other than hypothetical assumptions only. In addition the accountant should determine if the hypothetical assumptions are consistent with the purpose of the presentation.

- o The procedures in section 700.42 should be supplemented by the following considerations:

  - oo Is the purpose or limitations on the usefulness of the presentation disclosed?

  - oo Are accounting principles used consistent with the purpose of the presentation?

.10 The accountant should consider the support for the hypothetical assumptions in a multiple projection, as discussed in section 1700.06.

.11 In addition, the accountant should consider whether hypothetical assumptions are identified if he reviews either a multiple projection or other financial projections.

1/ Use of different accounting principles would not be consistent with the purpose (a general offering of debt or equity) of a multiple projection.

Section 1710 **Illustrative Engagement and Representation Letters**

.01 The following is a sample excerpt from an engagement letter for a review of a financial projection. The letter would be modified as appropriate.

This letter confirms our understanding of the arrangements for our review of the financial projection(s) if (describe hypothetical assumptions) of XYZ Company as of December 31, 19XX and for the year then ending for the purpose of issuing a report stating whether we believe (1) management's[1] financial projection(s) is (are) presented in conformity with applicable presentation guidelines established by the American Institute of Certified Public Accountants and (2) management's assumptions provide a reasonable basis for its projection(s) given the hypothetical assumptions.

Our review will be made in accordance with applicable guidelines of the American Institute of Certified Public Accountants for a review of a financial projection and, accordingly, will include procedures we consider necessary to evaluate (a) the assumptions used by management as a basis for the financial projection(s), (b) the preparation of the financial projection(s), and (c) the presentation of the financial projection(s).

The (multiple) financial projection presents, to the best of management's knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period based on (describe hypothetical assumptions). It is based on management's assumptions reflecting conditions it expects would exist and courses of action it expects would be taken, given (describe hypothetical assumptions).

Management is responsible for representations about its plans and expectations and for disclosure of significant information that might affect the ultimate realization of the projected results.

Even if (state hypothetical assumptions) were to occur, some assumptions inevitably will not materialize, and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period will vary from the projection(s) and the variations may be material. Our report will contain a statement to that effect.

We have no responsibility to update our report for events and circumstances occurring after the date of our report.

At the conclusion of the engagement, management agrees to supply us with a representation letter which, among other things, will confirm management's responsibility for the underlying assumptions and the appropriateness of the prospective financial statements and their presentation.

Our report will detail the nature of reservations, if any, we have with respect to the projection(s). Should any such reservations develop, we will discuss them with you before the report is issued.

1/ If the responsible party is other than management, the references to management should be replaced with the name or the third party who assumes responsibility for the assumptions.

We understand that the projection and our report thereon will be used only for (state intended, limited use).[2] If management intends to reproduce the projection(s) and our report thereon, they must be reproduced in their entirety and both the first and subsequent corrected drafts of the document containing the projection(s) and any accompanying material must be submitted to us for approval.[3]

.02 The following is a sample representation letter for a review of a financial projection. The written representations to be obtained should be based on the circumstances of the engagment.

Date of Accountant's report

To Accountant

In connection with your review of the projected balance sheet(s) and related statements of income, retained earnings, and changes in financial position and summaries of significant assumptions if (describe hypothetical assumptions) and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, we make the following representations:

1. The (multiple) financial projection presents our assumptions and, to the best of our knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period assuming (describe hypothetical assumptions).

2. The accounting principles used in the (multiple) financial projection are (consistent with (the special purpose of the projection))[4] (in accordance with the generally accepted accounting principles expected to be used by the company during the projection period, which are consistent with the principles that XYZ Company uses in preparing its historical financial statements).

3. The (multiple) financial projection is based on our judgment, considering present circumstances, of the expected conditions and our expected course of action if (describe hypothetical assumptions).

4. We have made available to you all significant information that we believe is relevant to the (multiple) financial projection.

5. We believe that the assumptions underlying the (multiple) projection are appropriate and reasonable given the hypothetical assumptions.

6. To the best of our knowledge and belief, the documents and records supporting the assumptions are appropriate.

2/ This sentence would be unnecessary for a review of a multiple projection.

3/ See also footnote 1, section 710.

4/ The alternative wording "consistent with (the special purpose of the projection)" would not be appropriate for a review of a multiple projection.

7. We believe the projected results are achievable if (describe hypothetical assumptions) were to occur; however, the projection could be favorably or unfavorably affected by many unforeseeable and uncontrollable factors.

8. We intend to use this projection for (describe intended use).5/

(Signatures)

5/ For a review of a multiple projection, the following representation would be substituted: "We believe, to the best of our knowledge, that the actual (describe hypothetical assumption) achieved will fall within the range presented for those assumptions; however, there can be no assuance that it will. Even if the actual (describe hypothetical assumption) achieved falls within the range presented for those assumptions, the multiple projection could be favorably or unfavorably affected by many unforseeable and uncontrollable factors."

Section 1720 — The Accountant's Report on Reviewed Financial Projections

.01 This section explains how the guidance in section 720, The Accountant's Report on Reviewed Financial Forecasts, would be modified for reviews of financial projections.

Accountant's Standard Report (section 720.01)
.02 The accountant's standard report on a review of a financial projection should include:

a. An identification of the financial projection presented and a description of what it is intended to represent.

b. A statement that the review of the financial projection was made in accordance with applicable AICPA guidelines and a brief description of the nature of such a review.

c. A statement that the accountant assumes no responsibility to update the report for events and circumstances occurring after the date of the report.

d. A statement regarding whether the accountant believes that the financial projection is presented in conformity with applicable AICPA presentation guidelines[1] and whether the underlying assumptions provide a reasonable basis for the presentation given the hypothetical assumptions.

e. A caveat regarding the ultimate attainment of the prospective results.

f. A caveat regarding the usefulness of the presentation.[2]

.03 The form of standard report on a review of a financial projection is as follows.

> The accompanying projected balance sheet,[3] statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of

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1/ The accountant's report need not comment on the consistency of the application of accounting principles as long as the presentation of any change in accounting principles is in conformity with the guidelines in section 400 (as modified by section 1400).

2/ This item would be unnecessary for a review of a multiple projection, since such presentations are suitable for general use.

3/ When the presentation is summarized as discussed in section 400.03, this sentence might read "The accompanying financial projection of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and accounting policies, presents, to the best of management's knowledge, a summary of the expected results of operations and changes in financial position for the projection period (describe or refer to hypothetical assumption, e.g., 'if a rate increase of 7.5% were granted, as disclosed in items b and c of the summary of significant assumptions,') and is not intended to represent an estimate of future financial results."

December 31, 19XX, and for the year then ending, present, to the best of management's[4] knowledge, the Company's expected financial position, results of operations, and changes in financial position for the projection period (describe or refer to hypothetical assumption, e.g., "if a rate increase of 7.5% were granted, as disclosed in items b and c of the summary of significant assumptions,") and is not intended to represent an estimate of future financial results. Accordingly, the financial projection reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action (describe hypothetical assumptions, e.g., "if the rate increase were granted").

We have reviewed the projection in accordance with applicable guidelines for a review of a financial projection established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the projection. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Based on our review, we believe the accompanying projection is presented in conformity with applicable guidelines for presentation of a financial projection established by the American Institute of Certified Public Accountants. We believe that the underlying assumptions provide a reasonable basis for management's projection given (describe hypothetical assumption, e.g., "the granting of the requested 7.5% rate increase"). However, even if (describe hypothetical assumption e.g., "the granting of the 7.5% rate increase occurred,") some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period will vary from the projection, and the variations may be material.

The accompanying projection and this report were prepared for (state special purpose, e.g., "presentation to the Public Utility Commission for its deliberations in regard to the requested rate increase") and should not be relied on for any other purpose.

.04 The form of standard report on a review of a multiple projection is as follows:

The accompanying projected balance sheets,[5] statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's[4] knowledge, the Company's expected financial positions,

4/ When the responsible party is other than management, the references to management in the standard report should be changed to refer to that third party who assumes responsibility for the assumptions.

5/ When the presentation is summarized as discussed in section 400.03 this sentence might read "The accompanying financial projections of XYZ Company as of December 31, 19XX, and for the year then ending, including the summaries of significant assumptions and acccounting policies, present, to the best of management's knowledge, summaries of the expected results of operations and changes in financial position for the projection period (describe or refer to hypothetical assumptions, e.g., 'predicated on occupancy rates of 60% and 80% of available apartments, as disclosed in items b and c of the summary of significant assumptions')."

results of operations, and changes in financial position for the projection period (describe or refer to hypothetical assumptions, e.g., "predicated on occupancy rates of 60% and 80% of available apartments, as disclosed in items b and c of the summary of significant assumptions"). Accordingly, the financial projections reflect its judgment, based on present circumstances, of the expected conditions and its expected course of action (describe hypothetical assumptions, e.g., "at each occupancy rate"). Management expects, to the best of its knowledge, that the actual (hypothetical assumption, e.g., "occupancy rate") achieved will be within the range shown; however, there can be no assurance that it will.

We have reviewed the projections in accordance with applicable guidelines for a review of a financial projection established by the American Institute of Certified Public Accountants. Our review included those procedures we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the projections. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Based on our review, we believe the accompanying projections are presented in conformity with applicable guidelines for presentation of a financial projection established by the American Institute of Certified Public Accountants. We believe the underlying assumptions provide a reasonable basis for management's projections given (describe hypothetical assumptions, e.g., "the occupancy rates of 60% and 80% of available apartments"). However, even if the (describe hypothetical assumption e.g., "actual occupancy rate") achieved is within the range shown, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the projection period may vary materially outside the range presented by the projections.

Circumstances Resulting in a Departure from Accountant's Standard Report (section 720.05(b))

.05 Because of the nature of financial projections (other than a multiple projection), a hypothetical assumption is not intended to provide a reasonable basis for the presentation. Thus, the accountant's standard report on a financial projection would not be affected by the reasonableness of the hypothetical assumption. If one or more of the other assumptions did not provide a reasonable basis for the presentation, however, the accountant would give an adverse report or withdraw from the engagement. Section 700.10 illustrates the form of adverse report, which would be adapted for a financial projection.

.06 If the accountant believes that the there is no reasonable expectation that the actual results will fall within the range of hypothetical assumptions presented in a multiple projection, the accountant should, if he is unable to obtain revised assumptions, give an adverse report or withdraw from the review engagement.

Section 1730 Considerations for the Accountant Reporting on a Review of a Multiple Projection Contained in Public Offering Documents

.01 The guidance in section 730 is generally applicable to reviews of multiple projections in public offering documents. The accountant should also consider the following:

(a) although a multiple projection is generally appropriate for use in public offering documents, a single financial projection is not (unless it supplements another presentation, see section 210).

(b) the wording of the examples given should be modified as appropriate for an engagement regarding a multiple projection.

Section 2000 Partial Presentations

Introduction

.01 A partial presentation as used in this guide is a presentation that excludes one or more of the minimum items required of prospective financial statements (see section 400.03). Examples of partial presentations are sales forecasts, projections that present operating income but not net income or significant changes in financial position, and forecasted tax returns that do not show significant changes in financial position.

.02 The AICPA is currently studying matters relating to preparation and presentation of partial presentations and to the accountant's association with, and reports on services provided with respect to, such presentations. This section does not attempt to address these matters in detail but provides some guidance as to the accountant's association with partial presentations, including reports on services provided with respect to such presentations.

Presentation

.03 A partial presentation is an appropriate type of presentation in many instances. For example, to analyze whether to lease or buy a piece of equipment or the income tax implications of a given election, it may be necessary only to assess the impact on one aspect of financial results rather than on the financial statements overall. However, partial presentations are limited-use presentations and are not appropriate for general offerings of debt or equity. Accordingly, the presentation should include a description of the purpose and any limitations on the usefulness of the presentation.

Accountant's Involvement with Partial Presentations

.04 When an accountant is associated with a partial presentation he should consider whether a presentation omitting one or more minimum items will adequately present the information based on its special purpose.

.05 The accountant who is associated with a partial presentation should consider the reporting guidance in Ethics rule 201(e), which states:

> A member shall not permit his name to be used in conjunction with any forecast[1/] of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast.

and Ethics interpretation 201-2, which states in part:

> When a member's name is associated with such forecasts, there shall be the presumption that such data may be used by parties other than the client. Therefore, full disclosure must be made of the sources of the information used and the major assumptions made in the preparation of the statements and analyses, the character of the work performed by the member, and the degree of responsibility he is taking.

1/ The Ethics rule and related interpretation were issued before the current definitions of financial forecast (section 200.03), financial projection (section 200.04), and association (section 500.01) were developed.