



**New Standards for  
Accounting and Review  
Services (SSARS 21)**

**Steven C. Fustolo, CPA**

**CPE Edition**

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# **New Standards for Accounting and Review Services (SSARS 21)**

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Steven C. Fustolo, CPA

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# Course Information

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**Course Title:** New Standards for Accounting and Review Services (SSARS 21)

**Learning Objectives:**

- Identify a change made in SSARS No. 21 that is carried over from auditing standards
- Recognize types of engagements which are authorized under SSARS No. 21
- Determine who the financial statements belong to when an accountant performs a review engagement for a client
- Pinpoint an example of a word that indicates that there is an unconditional requirement that must be followed by an accountant
- Discern how AR-C 70 treats the preparation of financial statements
- Recognize what cash, tax, regulatory and other bases of accounting are examples of
- Identify an aspect of peer review under AR-C 70
- Spot the type of report which must be issued when performing a preparation of financial statements engagement under AR-C 70
- Choose an item that should be documented in a preparation of financial statements engagement under AR-C 70
- Determine how assets on personal financial statements should be stated
- Recognize the objective of a compilation engagement
- Identify a procedure that an accountant should perform in a compilation engagement
- Determine what phrase is added to the first paragraph of the new compilation report under AR-C 80
- Discern what disclosures must be made if management elects to omit substantially all disclosures from special purpose framework financial statements
- Recognize what an accountant should do when there is a GAAP departure in a compilation engagement
- Pinpoint the type of engagements found in SSARS No. 19 which SSARS No. 21 eliminates
- Identify the term used for the date the accountant grants an entity permission to use the accountant's review report in connection with financial statements
- Discern who should sign the engagement letter in a review engagement
- Recognize examples of unusual or complex situations that an accountant should consider when making inquiries in a review engagement
- Spot an appropriate title for an accountant's review report

**Subject Area:** Auditing

**Prerequisites:** None

**Program Level:** Overview

**Program Content:** The purpose of this course is to inform the reader of the various changes made to the entire compilation and review codification by SSARS No. 21. The course addresses all three types of engagements that can be performed under the SSARSs including: a preparation of financial statements engagement, a compilation engagement, and a review engagement.

**Advance Preparation:** None

**Recommended CPE Credit:** 10 hours

## About the Author

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**Steven C. Fustolo** is a partner with the Boston CPA firm of James J. Fox & Company. He is a frequent lecturer and author of numerous tax and accounting issues affecting closely held businesses. An AICPA author, Mr. Fustolo's articles are regularly featured in *The Practical Accountant* and other publications. He is the author of *Practice Issues: Compilation and Review*, *Accounting and Auditing Reference Guide*, *Everything You Never Wanted to Know About GAAP*, *Enron: Fraud, Deception and the Aftermath*, *FASB Review for Industry*, *Current Developments: Accounting and Financial Reporting*, *Making Money with Special Engagements*, *Understanding the Variable Interest Entity Rules*, *FASB, SSARS and SAS Update and Review* and numerous other books and manuals that have been published by Practitioners Publishing Company (PPC), Commerce Clearing House (CCH), Thomson Reuters and the AICPA, among others. He is the recipient of several Outstanding Discussion Leader awards from many professional organizations including the New York and Florida Societies of CPAs. Mr. Fustolo's course entitled *FASB, SSARS and SAS Update and Review* continues to receive accolades and is regarded as one of the top live CPE programs in the country today with ratings that average 4.91 on a scale of 5.0. He speaks regularly for professional groups including being a guest lecturer at the AICPA Advanced Accounting and Auditing Technical Symposium. Mr. Fustolo is the recipient of the Elijah Watts Sells Award (AICPA) and Silver Medal (Massachusetts) for scores received on the CPA Examination.

# Table of Contents

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<b>Chapter 1 – Overview of the New Standards</b> .....	<b>1</b>
Learning Objectives .....	1
Issued .....	1
Effective Date .....	1
Objective .....	1
Background .....	1
Key changes made by SSARS No. 21.....	3
Review Questions.....	7
Review Answers .....	8
<b>Chapter 2 – AR-C Section 60—General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services</b> .....	<b>9</b>
Learning Objectives .....	9
Introduction.....	9
Key Changes Made to New AR-C 60 .....	9
Definitions .....	10
Requirements for Performing SSARS Engagements .....	11
Financial Statement Requirements.....	12
Ethical Requirements.....	13
Professional Judgment.....	13
Conduct of Performing the Engagement in Accordance With SSARSs .....	14
Engagement Level Quality Control .....	16
Acceptance and Continuance of Client Relationships and Engagements.....	17
Review Questions.....	19
Review Answers .....	20
<b>Chapter 3 – AR-C Section 70—Preparation of Financial Statements</b> .....	<b>21</b>
Learning Objectives .....	21
Effective Date .....	21
Introduction.....	21
Scope of AR-C 70.....	21
Definitions .....	26
Brief Summary of a Preparation of Financial Statements Engagement .....	28
General Rules in Applying a Preparation of Financial Statements Engagement Under AR-C 70 .....	29
Specific Rules for Preparing Financial Statements per AR-C 70 .....	31
Documentation in a Preparation Engagement .....	36
Engagement Letter—Preparation of Financial Statements Engagement.....	36
Exhibit: Illustrative Engagement Letter—Preparation Engagement .....	37
Illustrative Financial Statements—AR-C 70.....	40
Preparation of Personal Financial Statements.....	55
Review Questions.....	65
Review Answers .....	68
<b>Chapter 4 – AR-C Section 80—Compilation Engagements</b> .....	<b>72</b>
Learning Objectives .....	72
Introduction.....	72
Effective Date .....	73
Scope of AR-C 80—Compilation Engagements.....	73
Objective of a Compilation Engagement.....	74
Definitions .....	74
Requirements—Compilation Engagements—AR-C 80 .....	76
Engagement Letter—Compilation .....	78
The Accountant’s Knowledge and Understanding of the Entity’s Financial Reporting Framework— Compilation Engagement.....	93

## Table of Contents

Compilation Procedures.....	93
The New Accountant’s Compilation Report .....	94
Reporting When the Accountant Is Not Independent .....	100
Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework.....	101
Reporting Known Departures From the Applicable Financial Reporting Framework .....	101
Reporting on Supplementary Information .....	102
Elimination of Management use Only Financial Statements.....	105
Examples of the Accountant’s Compilation Reports on Financial Statements .....	106
Documentation in a Compilation Engagement.....	119
Review Questions.....	120
Review Answers .....	123
<b>Chapter 5 – AR-C Section 90—Review of Financial Statements .....</b>	<b>127</b>
Learning Objectives .....	127
Introduction.....	127
Scope of AR-C 90—Review of Financial Statements.....	128
Effective Date .....	129
Objective .....	129
Definitions .....	129
Requirements for Performing a Review Engagement Under AR-C 90.....	132
Illustrative Engagement Letters.....	135
Communication with Management and Those Charged With Governance.....	145
Understanding of the Industry .....	146
Knowledge of the Entity .....	146
Designing and Performing Review Procedures.....	147
Analytical Procedures .....	147
Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters .....	149
Reading the Financial Statements.....	151
Using the Work of Other Accountants .....	151
Reconciling the Financial Statements to the Underlying Accounting Records .....	151
Evaluating Evidence Obtained From the Procedures Performed .....	151
Materiality.....	152
Written Representations in a Review Engagement.....	153
Reporting on the Financial Statements.....	160
Communicating to Management and Others Regarding Fraud or Noncompliance With Laws and Regulations.....	172
Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant’s Review Report .....	173
Known Departures From the Applicable Financial Reporting Framework .....	175
Restricting the Use of the Accountant’s Review Report .....	176
The Accountant’s Consideration of an Entity’s Ability to Continue as a Going Concern .....	178
Subsequent Events and Subsequently Discovered Facts .....	179
Reference to the Work of Other Accountants in an Accountant’s Review Report .....	181
Supplementary Information That Accompanies Reviewed Financial Statements.....	182
Required Supplementary Information .....	184
Change in Engagement From Audit to Review .....	185
Review Documentation .....	186
Review Questions.....	187
Review Answers .....	190
<b>Chapter 6 – Implementation of SSARS No. 21 .....</b>	<b>194</b>
Review Questions.....	195
Review Answers .....	196
<b>Glossary.....</b>	<b>197</b>
<b>Index .....</b>	<b>201</b>

# Chapter 1

## Overview of the New Standards

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### Learning Objectives

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- Identify a change made in SSARS No. 21 that is carried over from auditing standards

### Issued

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October 23, 2014

### Effective Date

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SSARS No. 21 is effective for engagements performed in accordance with SSARSs for periods ending on or after December 15, 2015. Early implementation is permitted.

### Objective

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The purpose of SSARS 21 is to reissue most of the compilation and review standards under the Accounting and Review Services Committee's (ARSC's) Clarity Project.

### Background

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In October 2014, the AICPA's Accounting and Review Services Committee (ARSC) issued SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*.

The issuance of SSARS No. 21 represents the culmination of the ARSC's Clarity Project under which it seeks to clarify and revise the existing standards for reviews, compilations, and engagements to prepare financial statements.

In 2011, the Auditing Standards Board (ASB) reissued most of the existing auditing standards under its own Clarity Project with the issuance of SAS Nos. 122-124, which were subsequently supplemented with SAS Nos. 125-128. In issuing those clarified auditing standards, with an effective date of 2012, the ASB had as its primary goal to make improvements to existing auditing standards by establishing certain drafting conventions to more clearly state the auditor's objectives, and make the standards easier to read, understand and apply.

In May 2010, the ARSC approved and initiated its own Clarity Project to revise all existing compilation and review standards in the *Codification of Statements on Standards for Accounting and Review Services* (AR sections of the AICPA's *Professional Standards*). That project resulted in the issuance of SSARS No. 21.

In issuing SSARS No. 21, the ARSC follows a similar approach taken by the ASB to simplify existing compilation and review standards and by incorporating into the SSARSs some, but not all, of the conventions that are used within the reissued auditing standards such as:

- Establishing objectives for each clarified AR-C section
- Including a definitions section, where relevant, in each new AR-C section
- Separating requirements from application and other explanatory material
- Numbering application and other explanatory material paragraphs using a prefix and presenting them in a separate section that follows the requirements section
- Enhancing the readability of the SSARS by using formatting techniques, such as bulleted lists

The ARSC did not include in SSARS No. 21 specific application guidance for governmental entities and smaller, less complex entities, both of which are included in the new auditing standards.



## Chapter 1 – Overview of the New Standards

SSARS No. 21 supersedes SSARS No. 19 (AR sections 60, 80 and 90) and all other existing compilation and review (AR) sections in AICPA Professional Standards except for AR section 120, *Compilation of Pro Forma Financial Information*. AR Section 120 is expected to be clarified and exposed for public comment. Moreover, in 2015, the ARSC expects to issue new proposed requirements and guidance related to compilation of prospective financial information. Currently, the compilation of prospective financial statements rules are found in SSAE No. 10, *Attestation Standards: Revision and Recodification*.

SSARS No. 21 consists of four AR sections as follows:

- AR-C Section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*
- AR-C Section 70, *Preparation of Financial Statements*
- AR-C Section 80, *Compilation Engagements*
- AR-C Section 90, *Review of Financial Statements*

These four sections replace the existing AR sections with an “AR-C” to differentiate them from the existing sections. Sometime after the 2015 effective date of the new standards, the “C” will be dropped from the new standards.

Following is a mapping of existing AR sections to the new AR-C sections found in SSARS No. 21:

<b>Existing Standards (SSARS No. 19)</b>	<b>New AR-C Section (SSARS No. 21)</b>	<b>Description of Changes</b>
AR Section 60, <i>Framework for Performing and Reporting on Compilation and Review Engagements</i>	AR-C Section 60, <i>General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services</i>	The new AR-C 60 includes the general principles for engagements performed under the SSARSs and replaces existing AR 60.
NONE	AR-C Section 70, <i>Preparation of Financial Statements</i>	AR-C 70 is a new section that contains the requirements and guidance for performing a preparation of financial statements engagement.
AR Section 80, <i>Compilation of Financial Statements</i>	AR-C Section 80, <i>Compilation Engagements</i>	New AR-C 80 replaces existing AR 80 with respect to compilation engagements.
AR Section 90, <i>Review of Financial Statements</i>	AR-C Section 90, <i>Review of Financial Statements</i>	New AR-C 90 replaces existing AR 90 with respect to review engagements.

In addition to the new standards replacing existing AR Sections 60, 80 and 90, all other existing AR sections are replaced by SSARS No. 21 as follows:

<b>Other AR Sections Superseded by SSARS No. 21</b>			
<b>Existing AR Section</b>	<b>Existing Title</b>	<b>Superseded by SSARS No. 21</b>	<b>Not Superseded by SSARS No. 21</b>
AR Section 200 (SSARS No. 2, as amended)	Reporting on Comparative Financial Statements	X	
AR Section 300 (SSARS No. 3, as amended)	Compilation Reports on Financial Statements Included in Certain Prescribed Forms	X	

<b>Other AR Sections Superseded by SSARS No. 21</b>			
<b>Existing AR Section</b>	<b>Existing Title</b>	<b>Superseded by SSARS No. 21</b>	<b>Not Superseded by SSARS No. 21</b>
AR Section 400 (SSARS No. 4, as amended)	Communications Between Predecessor and Successor Accountants	X	
AR Section 600 (SSARS No. 6, as amended)	Reporting on Personal Financial Statements Included in Written Personal Financial Plans	X	
AR Section 110 (SSARS No. 13, as amended)	Compilation of Specified Elements, Accounts, or Items of a Financial Statement	X	
AR Section 120 (SSARS No. 14, as amended)	Compilation of Pro Forma Financial Information		X Pending—to be reissued in 2015

### **Key changes made by SSARS No. 21**

SSARS No. 21 makes several important changes to existing compilation and review standards which are summarized below:

#### **Introduces new general principles for performing engagements under the SSARSs in newly issued AR-C Section 60**

AR-C 60 does the following:

- Establishes the preconditions that must be met to perform an engagement under the SSARSs
- Inserts into AR-C 60 some of the definitions found in auditing standards that are based on SQCS No. 8, *A Firm's System of Quality Control*
- Clarifies that the financial statements on which an accountant performs a SSARS engagement belong to the client, not the accountant
- Expands the guidance on selection of the applicable financial reporting framework and overall guidance as requirements that must be met in order to prepare financial statements
- Expands the discussion and requirement for an accountant to exercise professional judgment
- Inserts new language on engagement-level quality control and the responsibilities of an engagement partner, and
- Inserts new guidance on acceptance and continuance of client relationships and engagements.

#### **Introduces new rules and guidance for engagements to prepare financial statements in newly issued AR-C Section 70**

AR-C 70 does the following:

- States that a preparation of financial statements engagement applies when the accountant is engaged to prepare financial statements but is not engaged to perform an audit, review or a compilation on those financial statements
- Establishes criteria that must be met for an accountant to accept and continue client relations in a preparation of financial statements engagement
- Permits the issuance of prepared financial statements without a report, provided a legend is placed on each page of the financial statements stating “no assurance” is being provided on the financial statements
- Defines a preparation of financial statements as a nonattest service

## Chapter 1 – Overview of the New Standards

- Requires an accountant to obtain an engagement letter signed by both the accountant and the client's management
- Does not require the accountant to consider whether he or she is independent in a preparation of financial statements engagement
- Permits prepared financial statements to be issued with or without disclosures, and
- Inserts into AR-C 70 the new special purpose framework definition (including a new definition of "tax basis") that is presently in auditing standards.

### **Makes changes to existing compilation engagement requirements in new AR-C Section 80**

AR-C 80 does the following:

- Retains most, but not all, of the existing requirements for compilations
- Establishes criteria that must be met for an accountant to accept and continue client relations in a compilation engagement
- States that a compilation engagement applies only when an accountant is engaged to perform a compilation engagement
- Eliminates the existing requirement that an accountant is forced to perform a compilation engagement if he or she has submitted financial statements (e.g., prepared and presented them)
- States that a compilation engagement always requires a report
- Eliminates the existing management use only compilation engagement
- Shortens and simplifies the compilation report versus the review or audit report, so that the new standard compilation report contains one paragraph, no heading, and no addressee
- Retains the requirement that an accountant modify the accountant's compilation report whenever the accountant's independence is impaired
- Requires the accountant to obtain an engagement letter signed by both the accountant and the client's management
- Includes a new sample engagement letter for a compilation engagement
- Retains the rules that a compilation engagement may be applied to financial statements with or without disclosures
- Expands the scope of compilation engagements under AR-C 80 to include a compilation of prospective financial information, including budgets, forecasts, or projections, and
- Inserts into AR-C 80, the new special purpose framework definition (including a new definition of "tax basis") that is presently in auditing standards.

### **Makes changes to existing review engagement requirements in new AR-C Section 90**

AR-C 90 does the following:

- Establishes criteria that must be met for an accountant to accept and continue client relations in a review engagement
- Inserts into the new AR-C 90, the special purpose framework definition (including a new definition of "tax basis") that is presently in auditing standards
- Requires the accountant to obtain an engagement letter signed by both the accountant and the client's management
- Includes a new sample engagement letter for a review engagement
- Slightly modifies the list of items that must be documented in a review engagement
- Inserts into AR-C 90 the requirement that an accountant should perform a review engagement with professional skepticism
- Includes a requirement that the accountant should communicate with management or those charged with governance matters concerning the review engagement that are of significant importance
- Clarifies that an accountant may perform audit procedures during a review engagement and the engagement is not elevated to an audit engagement

## Chapter 1 – Overview of the New Standards

- Expands slightly the list of examples of inquiries that an accountant may make of management in a review engagement
- Expands slightly the examples of analytical procedures and provides additional language that clarifies that the accountant must develop expectations in performing analytical procedures
- Includes a new requirement that an accountant should obtain evidence that the financial statements agree or reconcile with the accounting records
- Replaces the concept of “illegal acts” with “noncompliance with laws and regulations,” consistent with a change made to auditing standards
- Adds a new management representation letter, and a new requirement for management to attach to the representation letter a summary of uncorrected misstatements that are immaterial
- Introduces a new and expanded review report that includes headings and expanded language, consistent with some of the changes made to the audit report
- Provides better guidance regarding when an accountant should date the review report
- Introduces a new “other-matter” paragraph in a review report, consistent with this addition found in an audit report
- Clarifies the reporting options with respect to supplementary information in a review engagement, including the option to compile, review or disclaim supplementary information, and
- Includes expanded requirements and guidance in dealing with other accountants who have audited or review financial statements of significant components.

In drafting the new compilation and review standards, the ARSC did not follow international standards and, instead, used the new AU-C auditing standards format as a guide.

According to the ARSC, some of the AU-C standards were drafted using the corresponding International Standard on Auditing (ISA) as guidance. In contrast, the ARSC noted it was more appropriate to converge with the corresponding limited assurance engagement guidance in the American auditing literature than use international standards found in ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*. Although ARSC has considered International Standard on Related Services (ISRS) 4410, *Engagements to Compile Financial Statements*, and has adopted some of its requirements, AR-C 80 (compilation engagements) is not identical to ISRS 4410 because there continues to be several underlying premises, such as the requirement to determine independence, which is different in the United States.

Because SSARS No. 21 replaces most existing compilation and review standards, there will be a period of time during which practitioners will have little guidance in certain areas that have been superseded by SSARS No. 21.

For example, SSARS No. 21 provides minimal guidance for the following:

- SSARS No. 21 replaces SSARS No. 13, *Compilation of Specified Elements, Accounts or Items of a Financial Statement*, with respect to compilation engagements on specified elements, accounts and items of a financial statement, such as schedules of rental income, royalties, profit participation and other compilation engagements involving less than a complete financial statement. Yet, the new SSARS No. 21 gives no guidance on how to report on a specified element, account or item of a financial statement under the new SSARS No. 21 report.
- SSARS No. 21 replaces SSARS No. 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, related to a compilation engagement on a prescribed form such as a bank personal financial statement. SSARS No. 21 offers no guidance as to what the new SSARS No. 3 compilation report on a prescribed form looks like.

In 2015, the AICPA expects to issue a revised compilation and review guide that will have a new title *Review, Compilation, and Financial Statement Preparation Engagements*. That guide may fill in some of the missing guidance until the ARSC chooses to issue additional SSARSs or interpretations to address areas that require expanded guidance.

The remainder of this course is segregated into the following sections:

Chapter 1 – Overview of the New Standards

- AR-C Section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*
- AR-C Section 70, *Preparation of Financial Statements*
- AR-C Section 80, *Compilation Engagements*
- AR-C Section 90, *Review of Financial Statements*

**Carryover of certain elements found in auditing standards**

In issuing SSARS No. 21, the ARSC carried over certain elements in auditing standards to the SSARSs. Now, those elements are consistent across all engagements.

Following is a summary of those elements:

	Auditing Standards	CHANGES BY SSARS NO. 21		
		Preparation of Financial Statements	Compilation Engagements	Review Engagements
New definition of special purpose framework including “tax basis” financial statements	✓	✓	✓	✓
Introduction of “other matter” paragraph in report	✓		✓	✓
Engagement letter must be signed by accountant and management	✓	✓	✓	✓
Replacement of term “illegal acts” with “noncompliance with laws and regulations”	✓	✓	✓	✓

## Review Questions

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1. Which section of SSARS No. 21 pertains to compilation engagements?
  - A. Section 60
  - B. Section 70
  - C. Section 80
  - D. Section 90

**Review Answers**

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1. A. Incorrect. Section 60 is titled *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.
- B. Incorrect. Section 70 is titled *Preparation of Financial Statements*.
- C. **Correct.** Section 80 of SSARS No. 21 is titled *Compilation Engagements*.
- D. Incorrect. Section 90 is titled *Review of Financial Statements*

# Chapter 2

## AR-C Section 60

### *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*

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#### **Learning Objectives**

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- Recognize types of engagements which are authorized under SSARS No. 21
- Determine who the financial statements belong to when an accountant performs a review engagement for a client
- Pinpoint an example of a word that indicates that there is an unconditional requirement that must be followed by an accountant

#### **Introduction**

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AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*, was issued as part of SSARS No. 21, and supersedes existing AR-60, *Framework for Performing and Reporting on Compilation and Review Engagements*. The existing AR-60 was issued in 2009 as part of SSARS No. 19.

AR-C 60 does the following:

1. It provides the general principles for engagements performed in accordance with the SSARSs involving:
  - Preparation of Financial Statements (AR-C 70)
  - Compilation Engagements (AR-C 80), and
  - Review Engagements (AR-C 90).
2. It establishes the meaning of certain terms used within the SSARSs related to the professional requirements that must be satisfied in performing a review, compilation, or a preparation of financial statements engagement.
3. It assists accountants in understanding their professional responsibilities when performing an engagement in accordance with SSARSs.
4. It states that the SSARSs, as codified in the AR-C sections, are to be adapted as necessary in the circumstances when applied to reviews, compilations, or engagements to prepare other historical or prospective financial information.

**Note:** AR-C 60 also states that the SSARSs do not address the responsibilities of the accountant that may exist in legislation, regulation, or otherwise, and that may differ from those established in the SSARSs. In such circumstances, use of the SSARSs does not eliminate the accountant's responsibility to comply with all relevant legal, regulatory, or professional obligations.

#### **Key Changes Made to New AR-C 60**

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An accountant who performs an engagement under the SSARSs must follow the general principles found in newly issued AR-C 60, in addition to the requirements related to each particular type of engagements.



Thus, in considering the types of engagements covered by SSARS No. 21, an accountant must adhere to the following standards:

Type of Engagement	New Section	General Framework
Preparation of Financial Statements	AR-C 70	Must follow requirements in AR-C-60, General Principles
Compilation Engagement	AR-C 80	
Review Engagement	AR-C 90	

Although many of the existing provisions found in AR 60 have been carried over to the newly issued AR-C 60, other elements have been eliminated and the new AR-C 60 adds some new provisions. Following is a summary of some of the key changes that AR-C 60 makes to the existing AR 60:

1. Inserts into AR-C 60 some of the definitions found in auditing standards that are based on SQCS No. 8, *A Firm’s System of Quality Control*
2. Clarifies that the financial statements on which an accountant performs a SSARS engagement belong to the client, not the accountant
3. Expands the guidance on selection of the applicable financial reporting framework and overall guidance as requirements that must be met in order to prepare financial statements
4. Expands the discussion and requirement for an accountant to exercise professional judgment
5. Eliminates discussion of the concept of materiality in a SSARS engagement
6. Inserts new language on engagement-level quality control and the responsibilities of an engagement partner, and
7. Inserts new guidance on acceptance and continuance of client relationships and engagements.

## Definitions

AR-C 60 replaces the definitions found in existing AR 60 with new definitions, most of which are reflected in the new auditing standards. For purposes of SSARSs, the following terms have the meanings attributed as follows:

**Engagement partner:**<sup>1</sup> The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal, or regulatory body.

**Engagement team:**<sup>2</sup> All accountants and staff performing the engagement and any individuals engaged by the firm who perform procedures on the engagement.

<sup>1</sup> The term “engagement partner” is brought forward from QC Section 10, *A Firm’s System of Quality Control*, SQCS No. 8 and similarly used in auditing standards per AU-C 220, *Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards*.

<sup>2</sup> The term “engagement team” is brought forward from QC Section 10, *A Firm’s System of Quality Control*, SQCS No. 8 and similarly used in auditing standards per AU-C 220, *Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards*.

**Firm:**<sup>3</sup> A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public accounting.

**Interpretative publications:** Interpretations of SSARs; exhibits to SSARs; the AICPA Guide *Compilation and Review Engagements*<sup>4</sup>, guidance on reviews, compilations, and engagements to prepare financial statements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

**Other preparation, compilation and review publications:** Publications other than interpretative publications. These include AICPA accounting and review publications not defined as interpretative publications; the AICPA’s annual Alert *Developments in Review, Compilation, and Financial Statement Preparation Engagements*; articles addressing reviews, compilations, and engagements to prepare financial statements in the *Journal of Accountancy* and other professional journals; continuing professional education programs and other instructional materials, textbooks, guide books, programs for reviews, compilations, and engagements to prepare financial statements, and checklists; and other publications addressing reviews, compilations, and engagements to prepare financial statements from state CPA societies, other organizations, and individuals.

**Professional judgment:**<sup>5</sup> The application of relevant training, knowledge, and experience, within the context provided by Statements on Standards of Accounting and Review Services and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the review, compilation, or engagement to prepare financial statements.

## Requirements for Performing SSARS Engagements

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AR-C 60 provides the general principles that an accountant must satisfy before performing an engagement covered by the SSARs. Many of the requirements found in the new AR-C 60 are carried over from similar (but not identical) requirements found in auditing standards, more specifically AU-C Section 200, General Principles and Responsibilities.

For purposes of the SSARs, there are three engagements that SSARS No. 21 authorizes an accountant to perform:

- Preparation of financial statements
- Compilation of financial statements
- Review of financial statements

The following sections are addressed within the AR-C requirements that pertain to an accountant who performs any one of the three SSARS engagements noted above.

- Financial Statement Requirements
- Ethical Requirements
- Professional Judgment
- Conduct of Performing the Engagement in Accordance With SSARs
- Engagement Level Quality Control
- Acceptance and Continuance of Client Relationships and Engagements

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<sup>3</sup> The term “firm” is brought forward from QC Section 10, *A Firm’s System of Quality Control*, SQCS No. 8 and similarly used in auditing standards per AU-C 220, *Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards*.

<sup>4</sup> SSARS No. 21 states that the 2015 Guide will be entitled *Review, Compilation, and Financial Statement Preparation Engagements*

<sup>5</sup> As used in auditing standards, AU-C Section 200, *General Principles and Responsibilities*.

## Financial Statement Requirements

The financial statements that are the subject of a SSARS engagement belong to the entity, not the accountant. The SSARSs do not impose responsibilities on management and do not override laws and regulations that govern their responsibilities.

Prior to performing a SSARS engagement, an accountant must satisfy the preconditions for performing each type of engagement, as defined as:

- **Engagement to prepare financial statements:** Follows the preconditions found in paragraphs 9 and 10 of AR-C 70, *Preparation of Financial Statements*.
- **Compilation engagement:** Follows the preconditions found in paragraphs 8 and 9 of AR-C 80, *Compilation Engagements*.
- **Review engagement:** Follows the preconditions found in paragraphs 8 and 9 of AR-C 90, *Review of Financial Statements*.

**Note:** Although each type of engagement has its own list of preconditions that must be satisfied, there are certain preconditions found in paragraphs .24 and .25 of AR-C 60 that apply to all three SSARS engagements.

The preparation and fair presentation of the financial statements require:

- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations
- The preparation and fair presentation of the financial statements in accordance with that framework
- The inclusion of an adequate description of that framework in the financial statements, and
- Management to exercise judgment when making accounting estimates that are reasonable in the circumstances, as well as when selecting and applying appropriate accounting policies.

The financial statements may be prepared in accordance with one of the following:

- A **general purpose framework** (a financial reporting framework designed to meet the common financial information needs of a wide range of users, such as U.S. GAAP, or
- A **special purpose framework**, such as tax basis, regulatory basis, or contractual basis financial statements

Examples of financial accounting standards issued by organizations to be used by entities for preparing financial statements in accordance with a general purpose framework include:

- FASB standards issued as part of the FASB's *Accounting Standards Codification*®
- IFRS, issued by the IASB
- Statements of Federal Financial Accounting Standards, issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities, and
- Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities.

**Note:** The requirements of the applicable financial reporting framework determine what constitutes a complete set of financial statements. Under U.S. GAAP, a complete set of financial statements includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes.

For other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

- Balance sheet
- Statement of income or statement of operations

- Statement of retained earnings
- Statement of cash flows
- Statement of assets and liabilities
- Statement of changes in owners' equity
- Statement of revenue and expenses
- Statement of operations by product lines

AR-C 60 states that an accountant may perform a preparation, compilation or review engagement on a complete set of financial statements, or on an individual financial statement such as a balance sheet. The standards can also be applied to specified elements, accounts and items, as well as prospective financial statements (in certain cases). The financial statements may apply to either an annual period or for a shorter or longer period, depending on management's needs.

AR-C 60 notes that it is likely not appropriate for the entity to present financial statements for a period longer or shorter than an annual period in a comparative presentation with financial statements for an annual period.

### **Ethical Requirements**

The accountant should comply with relevant ethical requirements when performing an engagement in accordance with the SSARs.

Ethical requirements consist of those contained in the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.

The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

- Responsibilities
- The public interest
- Integrity
- Objectivity and independence
- Due care
- Scope and nature of services

Due care requires the accountant to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the engagement and enable an appropriate accountant's report to be issued, if applicable.

QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), establishes a firm's responsibilities to establish and maintain a system of quality control for SSARS engagements, and to establish policies and procedures designed to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.<sup>6</sup>

### **Professional Judgment**

AR-C 60 expands the guidance related to an accountant's professional judgment.

The general rule is that an accountant should exercise professional judgment in the performance of an engagement that is subject to the SSARSs. In exercising his or her professional judgment, AR-C 60 provides some guidance as follows.

Professional judgment is essential to the proper conduct of an engagement performed in accordance with SSARSs because interpretation of relevant ethical requirements and SSARSs, and the informed decisions required throughout the engagement, cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

The key feature of the professional judgment is that it is expected to be exercised by an accountant whose training, knowledge, and experience have assisted in developing the necessary competencies to

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<sup>6</sup> Paragraphs .21–25 of QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*).

achieve reasonable judgments and make informed decisions about appropriate courses of action in undertaking an engagement in accordance with SSARs.

The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the accountant throughout the engagement, including:

- knowledge acquired from engagements carried out for the entity's financial statements in prior periods, where applicable
- the accountant's understanding of the entity and its environment, including its accounting system, and of the application of the applicable financial reporting framework in the entity's industry, and
- the extent to which the preparation and presentation of the financial statements requires the exercise of judgment by management or the accountant.

**Note:** Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of SSARs and accounting principles and is appropriate in light of, and consistent with, the facts and circumstances that were known to the accountant up to the date of the issuance of financial statements prepared by the accountant or the date of the accountant's compilation or review report.

Professional judgment needs to be exercised throughout an engagement performed in accordance with SSARs. It also needs to be appropriately documented in accordance with the requirements of AR-C section 70, *Preparation of Financial Statements*, AR-C section 80, *Compilation Engagements*, or AR-C section 90, *Review of Financial Statements*. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or, in a review engagement, the evidence obtained.

## **Conduct of Performing the Engagement in Accordance With SSARs**

### **Complying With AR-C Sections Relevant to the Engagement and Other Relevant Requirements**

The accountant must perform a review, compilation, or a preparation of financial statements engagement in accordance with SSARs.

There is an exception under which the SSARs do not apply to a review of interim financial information which is performed under auditing standards, AU-C section 930, *Interim Financial Information* (AICPA, *Professional Standards*).

The accountant should comply with all AR-C sections relevant to the engagement. An AR-C section is relevant to the engagement when the AR-C section is in effect, and the circumstances addressed by the AR-C section exist.

An accountant should comply with each requirement of the relevant AR-C section unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist.

**Note:** There may be instances in which an accountant also may be required to comply with other requirements in addition to SSARs. The SSARs do not override law or regulation that governs a review, compilation, or an engagement to prepare financial statements. If such law or regulation does, in fact, differ from SSARs, an engagement conducted only in accordance with law or regulation will not necessarily comply with SSARs.

**Note:** An accountant may also conduct the compilation or review in accordance with both SSARs and International Standard on Related Services 4410 (Revised), *Compilation Engagements*, International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, or compilation or review standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the AR-C sections relevant to the engagement, it may be necessary for the accountant to perform additional compilation or review procedures in order to comply with the other compilation or review standards.

An accountant should not represent compliance with SSARs in the accountant’s compilation or review report unless the accountant has complied with the requirements of all AR-C sections relevant to the engagement.

The SSARs apply to engagements to prepare financial statements and compilations and reviews of financial statements of governmental entities.

**Note:** The accountant’s responsibilities may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an engagement performed under the SSARs. The SSARs do not encompass these additional responsibilities.

AR-C 60 requires that the accountant should have an understanding of the entire text of an AR-C section, including its application and other explanatory material, to understand its objectives and apply its requirements properly. The entire text of an AR-C section is relevant to an understanding of the objectives stated in an AR-C section and the proper application of the requirements of an AR-C section.

In addition to objectives and requirements, an AR-C section contains related guidance in the form of:

- Application and other explanatory material, and
- Introductory material that provides context relevant to a proper understanding of the AR-C section and definitions.

When necessary, the application and other explanatory material provides further explanation of the requirements of an AR-C section and guidance for carrying them out. In particular, it may explain more precisely what a requirement means or is intended to cover, include examples of procedures that may be appropriate in the circumstances. Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AR-C section.

**Note:** The accountant is required to understand the application and other explanatory material, how the accountant applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AR-C section. The words may, might, and could are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AR-C section.

Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AR-C section or within the title and introduction of the appendix itself.

Introductory material may include, as needed, such matters as explanation of the following:

- The purpose and scope of the AR-C section, including how the AR-C section relates to other AR-C sections
- The subject matter of the AR-C section
- The respective responsibilities of the accountant and others in relation to the subject matter of the AR-C section, and
- The context in which the AR-C section is set.

An AR-C section may include, in a separate section under the heading “Definitions,” a description of the meanings attributed to certain terms for purposes of SSARs. These are provided to assist in the consistent application and interpretation of SSARs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout SSARs.

#### **Defining Professional Responsibilities in the SSARs**

SSARS No. 21 carries over certain terms that describe the degree of responsibility imposed on accountants who perform engagements under the SSARs:

**Unconditional requirements:** The accountant must comply with an unconditional requirement in all cases in which such a requirement is relevant. An unconditional requirement is earmarked with use of the word “must.”

**Presumptively mandatory requirements:** The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare instances. Use of the term “should” indicates a presumptively mandatory requirement.

**Note:** If an AR-C section states that an accountant “should consider” performing a procedure or action, consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action, is based upon the outcome of the accountant’s consideration and the accountant’s professional judgment.

An accountant may depart from a relevant presumptively mandatory requirement in rare instances and such a departure is expected to arise only when the requirement is for a specific procedure to be performed, and, in specific circumstances of the engagement. In such a case, the accountant should perform alternative procedures to achieve the intent of the requirement.

### **Use of Interpretive Publications and Other Preparation, Compilation and Review Publications**

The accountant should consider applicable interpretative publications in the performance of a SSARS engagement.

Interpretative publications:

- Are not SSARSs and are recommendations on the application of the SSARSs in specific circumstances, including engagements for entities in specialized industries.
- Are issued under the authority of the ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed publication is consistent with the SSARSs.

Compilation and review interpretations of the SSARSs, and exhibits to the SSARSs are included in the AR-C sections.

Other preparation, compilation and review publications have no authoritative status, but might be helpful in understanding and applying the SSARSs. The accountant is not expected to be aware of the full body of other preparation, compilation and review publications.

### **Engagement Level Quality Control**

AR-C 60 provides guidance on implementing a SSARS engagement in accordance with a firm’s quality control standards. In particular, the engagement partner takes responsibility for the engagement.

In a SSARS engagement, the engagement partner should possess competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances.

The engagement partner should take responsibility for the following:

- The overall quality of each engagement to which that partner is assigned
- The direction, supervision, planning and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements
- The accountant’s report being appropriate in the circumstances, if applicable, and
- The engagement being performed in accordance with the firm’s quality control policies and procedures, including the following:
  - Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity.

- Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the engagement and expertise in financial reporting to:
  - Perform the engagement in accordance with professional standards and applicable legal and regulatory requirements, and
  - Enable a report that is appropriate in the circumstances to be issued, if applicable.
- Taking responsibility for appropriate engagement documentation being maintained.

**Relevant considerations after engagement acceptance:** If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take necessary action.

**Compliance with relevant ethical requirements:** Throughout the engagement, the engagement partner should remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team.

If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine the appropriate action.

**Monitoring:** An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.

The engagement partner should consider the results of the firm's monitoring process of the firm's system of quality control, as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the engagement.

Engagement teams, rather than the partner, have a responsibility to:

- Implement quality control procedures applicable to the engagement, and
- Provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

### **Acceptance and Continuance of Client Relationships and Engagements**

Regardless of whether an accountant performs a preparation, compilation or review engagement, the accountant is required to satisfy certain preconditions of the engagement found in the following:

- Paragraphs .24 and .25 of AR-C 60, and
- Specific preconditions found in the applicable section of the engagement type (AR-C 70, AR-C 80 or AR-C 90)

#### **Preconditions for all engagements found in AR-C 60:**

1. Paragraph .24 of AR-C 60 states that the accountant should not accept an engagement to be performed in accordance with SSARSS if:
  - a. The accountant has reason to believe that relevant ethical requirements (including independence) will not be satisfied
  - b. The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is not likely to be available or reliable, or
  - c. The accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.
2. Paragraph .25 of AR-C 60 states that as a condition for accepting a SSARS engagement, the accountant should do **all** of the following:



- a. Determine whether preliminary knowledge of the engagement circumstances indicates that ethical requirements (including independence) regarding professional competence will be satisfied.
  - b. Determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable. Factors that are relevant to the accountant's determination that the financial reporting framework selected by management is acceptable include the following:
    - (1) The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users), and
    - (2) Whether law or regulation prescribes the applicable financial reporting framework.
  - c. Obtain the agreement of management (through an engagement letter) that it acknowledges and understands its responsibility:
    - (1) for the selection of the financial reporting framework to be applied in the preparation of financial statements
    - (2) for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
    - (3) for preventing and detecting fraud
    - (4) for ensuring that the entity complies with laws and regulations applicable to its activities
    - (5) for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements
    - (6) to provide the accountant with:
      - access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
      - additional information that the accountant may request from management for the purpose of the engagement
      - unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries
3. In addition to satisfying the preconditions found in paragraphs .24 and .25 of AR-C 60, the accountant must satisfy certain engagement-specific conditions found in AR-C 70 (preparation engagements), AR-C 80 (compilation engagements), and AR-C 90 (review engagements), as follows:
- **Engagement to prepare financial statements:** Preconditions found in paragraphs 9 and 10 of AR-C 70, *Preparation of Financial Statements*.
  - **Compilation engagement:** Preconditions found in paragraphs 8 and 9 of AR-C 80, *Compilation Engagements*.
  - **Review engagement:** Preconditions found in paragraphs 8 and 9 of AR-C 90, *Review of Financial Statements*.

## Review Questions

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1. Which of the following represents a change made by SSARS No. 21 to the compilation and review standards?
  - A. AR-C section 60 represents a new section dealing with general principles that does not supersede any previous section
  - B. AR-C section 70 is a new section that does not supersede any previous section
  - C. AR-C section 80 is a new section that does not supersede any previous section
  - D. AR-C section 90 is a new section that does not supersede any previous section
  
2. What is one key change made by SSARS No. 21 which represents a carryover of an element found in auditing standards?
  - A. The “other matter” paragraph is eliminated from the report consistent with auditing standards
  - B. SSARS No. 21 carries over from auditing standards the requirement that analytical procedures be performed in a review engagement
  - C. SSARS No. 21 carries over from auditing standards the requirement that an accountant perform inquiries in a review engagement
  - D. The term “illegal acts” is changed to “noncompliance with laws and regulations”
  
3. Bill Taylor is an accountant who is hired to perform a compilation engagement under SSARS No. 21. Bill is considering how he has to follow certain interpretative publications in the performance of his engagement. Which of the following is correct in terms of how Bill should handle interpretative publications?
  - A. Interpretative publications are part of the SSARSs
  - B. Interpretative publications are not part of the SSARSs and are not issued under any authority
  - C. Interpretative publications are not part of the SSARSs and are issued under the authority of the ARSC
  - D. All interpretative publications are included in the SSARSs as exhibits.
  
4. Sara Winston is an accountant who is performing a review engagement. Sara identifies a procedure within the SSARSs that is earmarked by use of the term “should consider.” How is Sara supposed to handle this procedure under SSARS No. 21?
  - A. The procedure is an unconditional requirement and Sara has a choice to comply with the procedure
  - B. The procedure is a presumptively mandatory requirement that must be followed except in rare instances
  - C. The term “should consider” has no authoritative requirement as to whether the procedure should be followed
  - D. The procedure is an unconditional requirement that Sara must follow in all cases
  
5. Before an accountant accepts any engagement under SSARS No. 21, which of the following is a precondition that, if not satisfied, would result in the accountant not accepting the engagement?
  - A. Accountant has concerns about the integrity of third parties who might rely on the financial statements.
  - B. Accountant is concerned about the ethics of the bank to whom financial statements will be sent
  - C. Bankers have a history of not responding to receivable and cash confirmations
  - D. Accountant doubts management’s integrity

## Review Answers

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1.
  - A. Incorrect. AR-C section 60 supersedes previous AR section 60 found in SSARS No. 19.
  - B. **Correct.** SSARS No. 21 introduces a new AR-C section 70 for preparation of financial statements that did not exist under SSARS No. 19 and did not supersede any previous section.
  - C. Incorrect. AR-C section 80 replaces previous AR section 80 which is part of SSARS No. 19.
  - D. Incorrect. AR-C section 90 supersedes previous AR section 90, which is part of SSARS No. 19.
  
2.
  - A. Incorrect. SSARS No. 21 carries over the introduction (and not the elimination) of the “other matter” paragraph which is now authorized by auditing standards.
  - B. Incorrect. The requirement to perform analytical procedures in a review engagement is not carried over from auditing standards. This requirement has existed in review standards for years and is not influenced by any auditing standards.
  - C. Incorrect. SSARS No. 21 does not carry over from auditing standards the requirement that an accountant perform inquiries in a review engagement. Although it is true that inquiry procedures may be part of an audit engagement, as well as a review engagement, such procedures have been required in a review engagement for many years and is not influenced by auditing standards.
  - D. **Correct.** Auditing standards changed the term “illegal acts” to a new term “noncompliance with laws and regulations.” The new change is reflected in SSARS No. 21 consistent with the change made in auditing standards.
  
3.
  - A. Incorrect. SSARS No. 21 states that interpretative publications are not part of the SSARSs and are merely recommendations on how to apply the SSARSs in certain circumstances.
  - B. Incorrect. Although it is true that interpretative publications are not part of the SSARSs, it is not true that they are not issued under any authority. The Accounting and Review Services Committee (ARSC), an authoritative body, issues the interpretations making the answer incorrect.
  - C. **Correct.** SSARS No. 21 states that interpretative publications are not part of the SSARSs and are issued under the authority of the ARSC members. Thus, the answer is correct.
  - D. Incorrect. Compilation and review interpretations of the SSARSs, and exhibits to the SSARSs, are included in the AR-C sections of the SSARSs, but not necessarily as exhibits.
  
4.
  - A. Incorrect. The procedure is not an unconditional requirement. An unconditional requirement is identified with use of the term “must” and not “should consider.”
  - B. **Correct.** Use of the term “should consider” means the procedure is presumptively required under SSARS No. 21. A presumptively required procedure is followed except in rare instances and assuming it is also relevant. Thus, the answer is correct.
  - C. Incorrect. The term “should consider” does, in fact, have an authoritative requirement as a presumptively mandatory requirement under SSARS No. 21. Thus, the answer is incorrect.
  - D. Incorrect. SSARS No. 21 states that the term “should consider” is not indicative of an unconditional requirement even though it is true that if it were an unconditional requirement Sara would be required to follow the procedure in all cases.
  
5.
  - A. Incorrect. The integrity of third parties who might rely on the financial statements is not listed as a precondition under Paragraph .24 of AR-C 60, making the answer incorrect.
  - B. Incorrect. Whether the bank that will receive the financial statements is ethical or not does not impact the accountant. The accountant is performing the engagement for the entity, and not the bank.
  - C. Incorrect. In a SSARS No. 21 engagement (compilation, review or preparation), generally, confirmation procedures are not performed so that the accountant would not be concerned about whether the bank responds to receivable and cash confirmations. The accountant would, however, be concerned about getting other information that is necessary to perform the engagement.
  - D. **Correct.** SSARS No. 21 states that an accountant should not accept a SSARS engagement if he or she doubts management’s integrity to the extent that it is likely to affect the accountant’s performance of the engagement. Thus, the answer is correct.

# Chapter 3

## AR-C Section 70

### *Preparation of Financial Statements*

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#### **Learning Objectives**

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- Discern how AR-C 70 treats the preparation of financial statements
- Recognize what cash, tax, regulatory and other bases of accounting are examples of
- Identify an aspect of peer review under AR-C 70
- Spot the type of report which must be issued when performing a preparation of financial statements engagement under AR-C 70
- Choose an item that should be documented in a preparation of financial statements engagement under AR-C 70
- Determine how assets on personal financial statements should be stated

#### **Effective Date**

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AR-C Section 70 is effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

#### **Introduction**

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Although SSARS No. 21 rewrites all of the existing compilation and review standards, clearly the most significant change made by this SSARS is the introduction of a preparation of financial statements engagement within the newly issued AR-C 70.

Even though the preparation of financial statements is nothing new, per se, codifying standards on performing a preparation of financial statements engagement separate from a compilation, review or audit engagement, is novel.

AR-C 70 is a new section within the SSARSs and does the following:

- Introduces the preparation of financial statements engagement as a new engagement that may be performed separate from a compilation, review or audit engagement
- Codifies the preparation of financial statements as a nonattest service, and
- Provides guidance for the preparation of financial engagements that permits an accountant to issue prepared financial statements to a client or third party without a report.

In addition, although not part of AR-C 70, it is expected that the AICPA's peer review committee will exempt the preparation of financial statements engagement from being subject to peer review.

#### **Scope of AR-C 70**

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AR-C 70 inserts the preparation of financial statements as a separate engagement within the hierarchy of engagements that may be performed under the SSARSs as follows:

- Review Engagement
- Compilation Engagement
- Preparation of Financial Statements (NEW per AR-C 70)

AR-C 70 applies when an accountant in public practice is engaged to prepare financial statements and is not engaged to perform an audit, review or compilation engagement on those financial statements.

AR-C 70 may also be applied to the preparation of other historical or prospective financial information,<sup>1</sup> such as the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information
- Pro forma financial information, and
- Prospective financial information, including budgets, forecasts, or projections.

In order for a preparation of financial statements engagement to be subject to AR-C 70, the following elements must exist:

1. The accountant must be in public accounting
2. The accountant must be engaged (hired) by the client to perform a preparation of financial statements engagement, and
3. There must not be a corresponding compilation, review or audit engagement on the prepared financial statements for the same period.

### **Preparation of financial statements under AR-C 70 versus assisting in preparation of financial statements as a bookkeeping function**

The determination as to whether an accountant has been engaged to prepare financial statements (covered by AR-C 70) or merely to assist in preparing financial statements (which is a bookkeeping service that is not subject to AR-C 70), is determined based on services the client requests the accountant to perform, and requires the accountant to apply professional judgment.

The Appendix to AR-C 70, *Preparation of Financial Statements Versus Assistance in Preparing Financial Statements*, provides examples of services that an accountant may be engaged to perform and whether AR-C section 70 would apply.

### **Engagements to Which AR-C 70 Applies**

- Preparation of financial statements when the accountant is not engaged to perform an audit, review or compilation of such financial statements<sup>2</sup>
- Preparation of financial statements prior to an audit or review (or compilation)<sup>3</sup> by another accountant
- Preparation of financial statements for an entity to be presented alongside the entity's tax return
- Preparation of personal financial statements for presentation alongside a financial plan
- Preparation of a single financial statement, such as a balance sheet or income statement, or financial statements with substantially all disclosures omitted, and
- Using the information in a general ledger to prepare financial statements outside of an accounting software system.

### **Engagements to Which AR-C 70 Does Not Apply:**

- Preparation of financial statements when the accountant is engaged to perform an audit, review or compilation of such financial statements

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<sup>1</sup> The Accounting and Review Services Committee plans to expose for public comment separate proposed Statements on Standards for Accounting and Review Services that would provide requirements and guidance to accountants with respect to engagements on pro forma or prospective financial information.

<sup>2</sup> Implicit is that the preparation of financial statements engagement is performed simultaneously to or at a similar time to the performance of the compilation, review or audit engagement.

<sup>3</sup> SSARS No. 21 does not include "preparation of financial statements prior to a compilation by another accountant" as an engagement subject to AR-C 70. One reason why the compilation engagement was not included is because it was unlikely that an accountant would prepare financial statements prior to another accountant performing a compilation engagement. Nevertheless, implicit is that the preparation of financial statements prior to another accountant performing an audit, review or compilation engagement, would be subject to AR-C 70.

- Preparation of financial statements with a tax return solely for submission to taxing authorities
- Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
- Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
- Financial statements prepared in conjunction with business valuation services
- Bookkeeping services such as:
  - Maintaining depreciation schedules
  - Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
  - Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system
- Drafting financial statement notes

**Observation:** AR-C 70's standards for performing a preparation of financial statements engagement apply when an accountant in public practice is engaged (hired) to prepare financial statements as a stand-alone engagement and the accountant does not perform a compilation, review or audit engagement on those same financial statements for the same period. AR-C 70 also applies if the preparation of financial statements engagement is performed prior to the performance of an audit, review or compilation engagement by another accountant or auditor.

If, instead, the accountant performs a preparation of financial statements engagement and is also hired to perform an audit, review or compilation engagement on the same financial statements for that same period, AR-C 70 does not apply. Instead, the accountant should follow the guidance found in standards for the compilation, review or audit engagement. Regardless of whether a preparation of financial statements engagement is subject to AR-C 70 or not, a preparation of financial statements engagement is a nonattest service.

**Example 1:** Joe Smith CPA is engaged by a client to prepare financial statements for 20X5 (a nonattest engagement) and is not hired to perform a compilation, review or audit engagement on those same financial statements for 20X5.

**Conclusion:** Joe is performing a preparation of financial statements engagement (a nonattest service) and not performing a compilation, review or audit engagement on those same financial statements. AR-C 70 states that an accountant is engaged to perform a preparation of financial statements engagement and not engaged to perform an audit, review or compilation of such financial statements, the accountant must follow the standards found in AR-C 70 in performing the preparation of financial statements engagement.

**Example 2:** Joe Smith CPA is engaged by a client to prepare financial statements (a nonattest service) for 20X5 and is also hired to perform a compilation engagement on those same financial statements for 20X5.

**Conclusion:** Joe is hired to perform two engagements: a preparation of financial statements, and a compilation engagement on the same financial statements for the same period, 20X5. When an accountant is engaged to perform a preparation of financial statements and the accountant is also engaged to perform an audit, review or compilation on those same financial statements for that same period, the AR-C 70 standards do not apply to the preparation of financial statements engagement. Instead, Joe should follow compilation standards found in AR-C 80 in performing the compilation engagement. The preparation is a nonattest service for which no formal standards apply.

**Example 3:** Joe Smith CPA is engaged by a client to prepare financial statements (a nonattest service) for 20X5 and is also hired to perform a review engagement on those same financial statements for 20X5.

**Conclusion:** Joe is hired to perform two engagements: a preparation of financial statements and a review engagement on the same financial statements for the same period, 20X5. When an accountant is engaged to perform a preparation of financial statements and the accountant is also engaged to perform an audit, review or compilation on those same financial statements for that same period, the AR-C 70 standards do not apply to the preparation of financial statements engagement. Instead, Joe should follow review standards found in AR-C 90 in performing the review. The preparation is a nonattest service for which no formal standards apply.

**Example 4:** Joe Smith CPA is engaged by a client to prepare financial statements for 20X5 and is also hired to perform an audit engagement on those same financial statements for 20X5.

**Conclusion:** Joe is hired to perform two engagements: a preparation of financial statements, and an audit engagement on the same financial statements for the same period, 20X5. When an accountant is engaged to perform a preparation of financial statements and the accountant is also engaged to perform an audit, review or compilation on those same financial statements for that same period, the AR-C 70 standards do not apply to the preparation of financial statements engagement. Instead, Joe should follow the AU-C sections of the auditing standards, in performing the audit engagement. The preparation of financial statements engagement is a nonattest service to which no formal rules apply.

The following chart summarizes the standards that are followed when a preparation of financial statements engagement is prepared alone, or when it is performed in addition to the performance of a compilation, review or audit engagement.

Standards Followed						
Preparation of Financial Statements Engagement Performed Along With Compilation, Review or Audit Engagement						
TYPE OF ENGAGEMENT PERFORMED					Standards followed	Preparation of FS is a non-attest service
Preparation of financial statements (nonattest service)	Compilation engagement	Review Engagement	Audit Engagement			
✓				AR-C 70 Preparation	YES in all cases	
✓	✓			AR-C 80 Compilation		
✓		✓		AR-C 90 Review		
✓			✓	AU-C sections Auditing Standards		

In looking at the previous chart, a preparation of financial statements engagement is a nonattest service in all cases. The question is which rules should be followed when a preparation engagement is performed. If a preparation engagement is performed by itself, with no compilation, review or audit engagement being performed on the same financial statements, the accountant must follow the rules found in AR-C 70, which the author discusses further in this section. When, however, a preparation engagement is

performed and a compilation, review or audit engagement is also performed on those same statements, the AR-C 70 rules are not followed. Instead, the accountant follows the rules found in AR-C 80 (if a compilation engagement is performed), AR-C 90 (if a review engagement is performed), and the auditing standards found in AU-C sections (if an audit engagement is performed).

**What if the accountant performs a preparation engagement and subsequently is asked to perform a compilation, review or audit engagement for the same period?**

AR-C 70 states that the preparation of financial statement standards found in AR-C 70 apply if the accountant is engaged to perform a preparation of financial statements engagement, and is not engaged to perform a compilation, review or audit engagement on those same financial statements for the same period.

Implicit in that definition is that the compilation, review or audit engagement is performed at the same or a similar time the preparation engagement is performed.

However, there could be instances in which an accountant performs a preparation engagement, and then, sometime in the future, that accountant is asked to perform a compilation, review or audit engagement on those same financial statements for the same period. In such a case, which set of rules apply? This issue is not specifically addressed in AR-C 70.

The author believes that if a preparation engagement is performed, and then in the future, a compilation, review or audit engagement is performed on the same financial statements for the same period of time, the engagements should be treated as two separate and distinct engagements. The original preparation of financial statements engagement follows the preparation of financial statements standards found in AR-C 70. Then, when the compilation, review or audit engagement is performed subsequent to (but not simultaneously with) the preparation of financial statements engagement, the compilation, review or audit standards apply to that engagement.

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**Example:** Jimmy Fox CPA performs a preparation of financial statements engagement for the year ended December 31, 2015 and issues the prepared financial statements on March 31, 2016. On July 1, 2016, the client asks Jimmy Fox to perform a review engagement for December 31, 2015 year end.

**Conclusion:** The preparation engagement and the review engagement should be treated as two separate engagements that follow two sets of standards. The initial preparation engagement follows the AR-C 70 standards for preparation of financial statements. When the review engagement is subsequently performed, Jimmy should follow the review standards found in AR-C 90. The fact that a review engagement is performed for the same period and for the same financial statements for which a preparation engagement is performed, is ignored because the engagements are not performed simultaneously or at a similar time.

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**Change the facts:** Assume instead that both the preparation of financial statements and review engagements are performed simultaneously for 2015.

**Conclusion:** Because a review engagement is performed at the same time the preparation engagement is performed for the same period (2015), the AR-C 70 standards do not apply to the preparation engagement. Instead, the accountant should follow the review standards found in AR-C 90 in performing the review engagement, with the preparation of financial statements treated as a nonattest service performed for an attest engagement (review engagement).

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**Why should an accountant care whether a preparation of financial statements engagement is subject to the AR-C 70 standards?**

The reality is that the accountant should not really care whether the preparation of financial statements engagement is covered by the AR-C 70 rules or not.



In all cases, the preparation of financial statements is a nonattest service, just like the preparation of a tax return, bookkeeping services, payroll tax services, etc. The only issue is whether that preparation is an engagement to which the accountant must follow the AR-C 70 standards. If the accountant is hired to perform a preparation of financial statements engagement and there is no compilation, review or review engagement performed on those same financial statements for that same period, then the AR-C 70 standards apply. Once AR-C 70 applies, in performing the preparation of financial statements engagement, the accountant must follow the rules found in AR-C 70 that include obtaining a signed engagement letter, including a “no assurance” legend on each financial statement, in certain cases, including a disclaimer report, and more. These AR-C 70 rules are addressed further on in this section.

If, instead, a preparation of financial statements engagement is performed and the accountant also performs a compilation, review or audit on those same statements, AR-C 70 rules do not apply. Thus, the preparation of financial statements engagement is not subject to any formal rules. In such a case, the accountant must follow the standards pertaining to the compilation, review or audit engagement but not specific standards related to the preparation of financial statements engagement.

**What happens if a preparation engagement is performed at interim and a compilation, review or audit engagement is performed for the annual period?**

It is common for an accountant to prepare interim financial statements (e.g., monthly or quarterly) and then prepare annual financial statements.

**Example:** An accountant is hired to prepare monthly financial statements for 11 months. Then, at year end, the accountant is hired to perform a review engagement on the annual financial statements for the bank.

**Conclusion:** First, let’s look at the services that are being performed. There is:

1. A preparation of financial statements engagement (a nonattest service) on a stand-alone basis performed on a monthly basis, for eleven months.
2. An annual review engagement and annual preparation of financial statements.

With respect to the preparation of the eleven monthly financial statements, the AR-C 70 standards apply because for each of those eleven engagements, no compilation, review or audit engagement is performed.

With respect to the annual financial statements, two types of engagements are being performed: a preparation of financial statements (nonattest service) and a review engagement. When an accountant is engaged to perform a preparation of financial statements service and the accountant is also hired to perform a compilation, review or audit engagement on the same financial statements for the same period, the AR-C 70 rules do not apply to the preparation of financial statements. Instead, the accountant should follow the review standards found in AR-C 90.

**Definitions**

AR-C 70 includes the following definitions that are also included in AR-C 80 (compilation engagements) and AR-C 90 (review engagements).

**Applicable financial reporting framework:** The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

**Financial reporting framework:** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, U.S. GAAP,

International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

**Management:** The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

**Special purpose framework:** A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting:

- a. **Cash basis:** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis:** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis:** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- d. **Contractual basis:** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis:** A basis of accounting that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as other comprehensive bases of accounting (OCBOA).

**Note:** Paragraph A4 of AR-C 70 states that certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all of the requirements of GAAP. Such frameworks are regulatory-bases of accounting. However, there are instances in which the cash or tax basis of accounting may be permitted by a regulator. In such cases, the cash and tax bases of accounting are not considered regulatory-bases of accounting.

**Those charged with governance:** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel, for example, executive members of a governance board or an owner-manager.

### Definition of Special Purpose Framework

SSARS No. 21 carries over the definition of a special purpose framework found in auditing standards, AU-C 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

Under AU-C 800, the term OCBOA is replaced with the term special purpose framework.

Further, the definition of income tax basis is changed slightly from the previous one found in SSARS No. 19. The SSARS No. 19 definition was “a basis of accounting that the entity uses or expects to use to file its income tax return for the period covered by the financial statements.” The new definition removes the “expects to use” from the definition. As a practical matter, eliminating the “expects to use” from the definition should have no significant effect on the application of the SSARS.

Lastly, the term “income tax basis” has been replaced with the term “tax basis.”

## Brief Summary of a Preparation of Financial Statements Engagement

Before the author addresses the details of the AR-C 70 standards for an engagement to prepare financial statements, let's look at a summary of what a preparation of financial statements engagement is:

- An accountant performs a preparation of financial statements engagement if he or she is in public accounting, and is engaged to prepare financial statements (e.g., there is an engagement letter to hire the accountant to perform the preparation engagement).
- A preparation of financial statements engagement is a nonattest service
- An engagement letter that is signed by both management and the accountant is required
- The accountant is not required to be independent nor determine whether he or she is independent
- There is generally no report issued with the prepared financial statements, subject to a disclaimer report exception
- The financial statements may be issued to the client or third party without restrictions
- The financial statements may omit notes/disclosures
- The financial statements may have GAAP/other framework departures
- The preparation of financial statements engagement may be exempt from peer review
- There is no separate reporting or disclosure reference to supplementary information

The following chart compares the key elements of a preparation engagement with a compilation engagement.

<b>Comparison of Preparation Versus Compilation Engagement</b>		
	<b>Compilation Engagement (AR-C 80)</b>	<b>Preparation of Financial Statements (AR-C 70)</b>
When does the standard apply?	When an accountant is engaged to perform a compilation	When an accountant is engaged to prepare financial statements and not engaged to perform a compilation, review or audit on those same financial statements
Must the accountant be in public accounting?	Yes	Yes
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	Yes	No
If the accountant is not independent, is that fact required to be disclosed?	Yes	N/A
Does the engagement require a report?	Yes	No <sup>4</sup>
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes
May the financial statements have a departure from the applicable financial reporting framework?	Yes	Yes
Is there any special reporting or reference to supplementary information?	Yes	No
Source: <i>Developments in Review, Compilation and Financial Statement Preparation Engagements 2014/2015</i> (AICPA), as modified by the Author.		

<sup>4</sup> In certain cases, a disclaimer report may be required.

## A Preparation Engagement and Peer Review

An important issue that practitioners want answered is whether a preparation of financial statements engagement, by itself, is subject to peer review.

In August 2014, the AICPA Peer Review Board issued an exposure draft entitled, *Proposed Changes to the AICPA Standards for Performing and Reporting on Peer Reviews—Preparation of Financial Statements Performed under SSARS and the Impact on the Scope of Peer Review*.

The peer review exposure draft, which had a comment deadline of October 2014, states the following:

1. Preparation services performed under SSARS are excluded from the scope of peer review and the definition of an accounting and auditing practice for purposes of the peer review standards.
2. Engagements performed under the Preparation of Financial Statements standard (AR-C 70), are excluded from the scope of the AICPA peer review.

That means that if a firm only performs preparation of financial statement engagements, no peer review would be required if the peer review exposure draft is passed.

If, instead, a firm performs compilation, review or audit engagements, and also performs a preparation of financial statements engagement, the firm would be subject to peer review, but the preparation engagement may not be an engagement that would be selected by a peer reviewer for that peer review.

The AICPA peer review exposure draft is expected to be voted on in 2015.

## General Rules in Applying a Preparation of Financial Statements Engagement Under AR-C 70

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Following are the rules that apply to a preparation of financial statements engagement covered by AR-C 70:

1. In addition to complying with the rules in AR-C 70, an accountant is required to comply with AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.
2. An accountant must satisfy the preconditions found in paragraphs .24 and .25 of AR-C 60 general principles.

**Paragraph .24 of AR-C 60** states that the accountant should not accept an engagement to be performed in accordance with SSARSs if:

- a. The accountant has reason to believe that relevant ethical requirements (including independence) will not be satisfied
- b. The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is not likely to be available or reliable, or
- c. The accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.

**Paragraph .25 of AR-C 60** states that as a condition for accepting an engagement to be performed in accordance with SSARSs, the accountant should do all of the following:

- a. Determine whether preliminary knowledge of the engagement circumstances indicate that ethical requirements regarding professional competence will be satisfied.
- b. Determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable.
- c. Obtain the agreement of management (e.g., engagement letter) that it acknowledges and understands its responsibility:
  - (1) for the selection of the financial reporting framework to be applied in the preparation of financial statements
  - (2) for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error

- (3) for preventing and detecting fraud
- (4) for ensuring that the entity complies with laws and regulations applicable to its activities
- (5) for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements
- (6) to provide the accountant with:
  - access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
  - additional information that the accountant may request from management for the purpose of the engagement
  - unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries

If the accountant is not satisfied with any of the matters set out in general principles found AR-C section 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

3. A preparation of financial statements engagement is subject to the AR-C 70 rules if three elements are satisfied:
  - The accountant is in public accounting
  - The accountant is hired to perform a preparation of financial statements engagement, and
  - The accountant is not hired to perform a compilation, review or audit engagement on the same financial statements for the same period of time.
4. The preparation of financial statements is a nonattest service.
5. The accountant is not required to determine whether the accountant is independent to perform a preparation of financial statements engagement under AR-C 70.

**Note:** Although an accountant is not required to be independent to perform a preparation of financial statements engagement, the accountant must be careful when he or she prepares financial statements (a nonattest service) for an interim period and then performs a compilation, review or audit engagement at annual year end.

The *Nonattest Services* subtopic of the *Independence Rule* (found in the AICPA Professional Standards, ET sec. 1.295) addresses the accountant's considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and also be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The performance of the preparation services may impair independence unless the safeguards described in the nonattest services subtopic are met.

Those safeguards, which are discussed further on in the review section of this course, include three requirements: 1) The accountant must not assume responsibilities for the preparation of financial statements service, 2) The client must agree to assume all management responsibilities for the preparation of financial statements service, and 3) There must be language in the engagement letter that confirms that the client, not the accountant, assumes management responsibility for the nonattest service performed (e.g., preparation of financial statements).

6. In the preparation of financial statements, the accountant is not required to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.
7. The accountant should obtain an agreement of management (engagement letter) signed by both the accountant and management.
8. The accountant should obtain an understanding of:
  - the applicable financial reporting framework, and
  - the significant accounting policies intended to be used in the preparation of the financial statements.

**Note:** AR-C 70 states that the requirement for the accountant to obtain an understanding of the financial reporting framework adopted by management and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain the required understanding from various sources. For example, such sources may include consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry.

### **Specific Rules for Preparing Financial Statements per AR-C 70**

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AR-C 70 provides specific rules that must be followed if an accountant performs a preparation of financial statements engagement:

1. The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.
2. The accountant does not include a report with the prepared financial statements subject to the disclaimer report exception noted below.
3. Because a report is not included with the prepared financial statements, the accountant should ensure that a legend is included on each page of the financial statements indicating, at a minimum, that “no assurance is provided” on the financial statements.

**Note:** AR-C 70 states that the “no assurance is provided” statement (legend) on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant’s involvement with the financial statements.

Because the financial statements are the responsibility of management, the “no assurance” statement (legend) is made at management’s discretion, and the accountant or the accountant’s firm name is not required to be included within that legend.

Examples of a statement (legend) that should be included on each page of the financial statements follows:

*“No assurance is provided on these financial statements.”* or

*“These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.”*

Other legends may be used, provided they convey that no assurance is provided on the financial statements.

4. If the accountant is unable to include a “no assurance is provided” legend on each page of the financial statements, the accountant should issue either:
- A disclaimer report that makes clear that no assurance is provided on the financial statements, or,
  - A compilation report in accordance with AR-C section 80, *Compilation Engagements*.

An example of a disclaimer report that the accountant may issue follows:

To Management and Board of Directors  
XYZ Company

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by me (us) and, accordingly, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

Signature of accounting firm or accountant  
Accountant’s city and state

**Observation:** The financial statements belong to the client, not the accountant. Therefore, there could be rare instances in which the client does not want a legend such as “no assurance is provided” on the financial statement pages of prepared financial statements. In such a case, the accountant cannot force the client to add the legend because the financial statements do not belong to the accountant. Therefore, the accountant can issue a disclaimer report to notify the user that no assurance is provided with respect to the financial statements.

5. When preparing financial statements in accordance with a special purpose framework (such as tax basis), the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements.

XYZ Company  
Balance Sheet—**Tax Basis**  
December 31, 20X5

**Note:** SSARS No. 21 states that a description of the special purpose framework is usually placed either:

- Next to the title of the financial statements (example: statement of assets and liabilities—modified cash basis), or
- Under the title of the financial statements.

However, the description may be placed elsewhere in the financial statements.

**Does the fact that a financial statement title includes the special purpose framework in its title (e.g., tax basis), satisfy the requirement to include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements?**

Yes. Paragraph A13 of SSARS No. 21 states that the description can be in the form of a suffix “next to or under the title of the financial statements.” Thus, as long as the financial statement title includes a suffix such as “Balance Sheet—Tax Basis” the suffix “tax basis” that is included in the title, satis-

fies the requirement to include a description of the framework either on the face of the financial statement or in a note.

A preferred approach to including a description of the special purpose framework is to include it in the title as follows:

XYZ Company  
Balance Sheet—**Tax Basis**  
December 31, 20X5

Paragraph A13 also allows for the description to be placed under the title, or elsewhere on the face of the financial statements on in an accompanying note.

One example is as follows:

XYZ Company  
Balance Sheet—Tax Basis  
**Tax Basis**  
December 31, 20X5

In reviewing the above example, it is obvious that including the term “tax basis” immediately below the title is redundant in that the term “tax basis” is shown twice.

6. If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in the financial statements and accepts responsibility for those judgments.  
Examples of situations in which an accountant may provide assistance to management include:
  - Advising management on alternative accounting policies that are significant to the financial statements, or
  - Helping management with significant judgments regarding material accounting estimates.The accountant may wish to document significant consultations or significant judgments regarding amounts or disclosures to be reflected in the financial statements.
7. If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statement are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information.

**Observation:** AR-C 70 carries over from the compilation standards (AR-C 80) the language related to “incomplete, inaccurate, or otherwise unsatisfactory” documents or information. Specifically, under AR-C 80 (compilation of financial statements) and the above language related to a preparation of financial statements under AR-C 70, if an accountant discovers incomplete, inaccurate or otherwise unsatisfactory information during the engagement, the accountant must bring that information to the attention of management and request that management correct the information. What this means is that in performing a preparation of financial statements engagement, an accountant has the same responsibility as an accountant who performs a compilation engagement. That is, if there is a material item that comes to the accountant’s attention, he or she must address it and request that management correct it. The fact that an accountant is performing a preparation engagement is not a defense against not researching a potentially material misstatement.



8. When, after discussions with management, the accountant prepares financial statements that contain a known departure(s) from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement(s) in the financial statements.

The disclosure of a material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements and may look like this:

*“The financial statements do not include a statement of cash flows which is required under generally accepted accounting principles in the United States.”*

or

*“The financial statements do not include a statement of cash flows.”*

9. When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission in the financial statements.

The disclosure of the omission of substantially all disclosures required by the applicable financial framework may be made on the face of the financial statements or in a note to the financial statements.

Example of a disclosure presented on the face of the financial statements or in the notes to the financial statements follows:

*“Substantially all disclosures required by accounting principles generally accepted in the United States are not included.”*

**Note:** The accountant should not prepare financial statements that omit substantially all disclosures required by the applicable financial reporting framework if the accountant becomes aware that the omission of substantially all disclosures was undertaken with the intention of misleading users of such financial statements.

10. If the prepared financial statements include supplementary information, there is no separate disclosure or other reporting reference to that supplementary information.

#### **Combination of no statement of cash flows and substantially all disclosures omitted**

In most instances, accountants who perform a preparation of financial statements engagement will prepare financial statements that omit the statement of cash flows and substantially all disclosures.

The prepared financial statements will typically consist of three pages and no footnotes as follows:

- Balance sheet
- Statement of income
- Schedule of operating expenses

If this is the case, the legend on each of the three pages would consist of the following three components:

1. *“No assurance is provided on these financial statements.”*
2. *“The financial statements do not include a statement of cash flows.”*
3. *“Substantially all disclosures required by accounting principles generally accepted in the United States are not included.”*

**Note:** Technically, the schedule of operating expenses is not a financial statement and the legends that are required to be placed on each page of the financial statements do not have to be placed on the schedule. The author suggests that an accountant treat the schedule of operating expenses and any other supplementary information “as if” it is a financial statement. In doing so, the accountant would include legends on each page of the supplementary information even though it is not required.

**Is an accountant permitted to include in a disclaimer report, the disclosure about the GAAP departure and/or omission of disclosures?**

No. AR-C 70 requires that a disclosure be presented either on the face of the financial statements or in the notes to financial statements in two instances:

- There is a GAAP (or other framework) departure, or
- Substantially all disclosures are omitted.

AR-C 70 provides that if there is a GAAP (or other framework) departure and/or substantially all disclosures are omitted, the accountant must ensure that a disclosure (legend) is made either on the face of the financial statements or in the notes to those financial statements.

A disclaimer report is required if a client refuses to include on each page of the financial statements a legend, “no assurance is provided on these financial statements” or similar language.

There is no authority within AR-C 70 that permits an accountant to include in a disclaimer report, a disclosure (legend) of a GAAP (or other framework) departure or omission of substantially all disclosures.

The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled:

*“Selected Information—Substantially All Disclosures Required by [the applicable financial reporting framework] Are Not Included.”*

**Should there be any reference to supplementary information in prepared financial statements?**

No. AR-C 70 does not require that there be any special legend or other reporting requirements with respect to any supplementary information that might be included in prepared financial statements.

Paragraph 2 of AR-C 70 states that the preparation of financial statements standards may also be applied to the preparation of other historical or prospective financial information that includes supplementary information, including required supplementary information.

However, the AR-C 70 standard applies to the preparation of financial statements, not supplementary information. Thus, if a preparation engagement is performed on financial statements and supplementary information is included, such as a schedule of operating expenses, the rules found in AR-C 70 do not apply to that supplementary information. That means there is no requirement that each page of the supplementary information have a “no assurance” legend. That said, the author suggests that an accountant add the “no assurance” language to any schedules of supplementary information, even though not required.

**Legends when there are tax basis financial statements**

If an accountant prepares financial statements under a special purpose framework, such as tax basis financial statements, the legends that are required to be placed on each page of the financial statements differ from the legends required for GAAP statements.

- **No assurance is provided on these financial statements:** Is required for all financial statements, including those prepared on the tax basis.
- **The statement of cash flows is not included:** No legend is required because a statement of cash flows is not required under the tax basis of accounting.
- **Substantially all disclosures are omitted:** The legend must be modified to state that:

*“Substantially all disclosures ordinarily included in financial statements prepared on the tax basis of accounting are not included.”*

The following chart compares the required legends for U.S. GAAP versus tax basis financial statements.

Comparison of Legends Required for GAAP Versus Tax Basis Financial Statements		
Legend	GAAP Financial Statements	Tax Basis Financial Statements
Standard “no assurance disclaimer”	<i>“No assurance is provided on these financial statements.”</i>	<i>“No assurance is provided on these financial statements.”</i>
No statement of cash flows present-ed (GAAP departure)	<i>“The financial statements do not include a statement of cash flows”</i>	NA No legend is required <sup>5</sup>
Substantially all disclosures omitted	<i>“Substantially all disclosures required by accounting principles generally accepted in the United States are not included.”</i>	<i>“Substantially all disclosures ordinarily included<sup>6</sup> in financial statements prepared in accordance with the tax basis of accounting are not included.”</i>

### Documentation in a Preparation Engagement

The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

- The engagement letter or other suitable form of written documentation with management
- A copy of the financial statements that the accountant prepared
- If applicable, documentation regarding significant consultations or significant judgments regarding amounts or disclosures to be reflected in the financial statements, and
- If applicable, if the accountant departs from a relevant presumptively mandatory requirement, documentation of the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

**Observation:** Typically, the only two items that an accountant will have to document in a preparation of financial statements engagement will be an engagement letter, and a copy of the prepared financial statements, identified as items (a) and (b), respectively above. It will be unusual for items (c) and (d) above to apply as they are both nonrecurring items.

### Engagement Letter—Preparation of Financial Statements Engagement

As a condition for accepting an engagement to prepare financial statements, in addition to the precondition requirements in paragraphs .24 and .25 of AR-C 60, the accountant should obtain the agreement with management. That agreement must be in writing and must be signed by both the accountant and management.

AR-C 70 provides the following guidance for an accountant to obtain agreement on the engagement terms:

1. The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate.
  - a. When the agreement on the terms of engagement is only with those charged with governance, the accountant is required to obtain management’s agreement that it acknowledges and understands its responsibilities.

<sup>5</sup> A statement of cash flows is required only for GAAP financial statements. Thus, the omission of a statement of cash flows in tax basis financial statements is not a departure.

<sup>6</sup> With respect to tax basis financial statements, the term “ordinarily included” replaces the term “required” because there are no specific disclosures codified for tax basis financial statements.

- b. When a third party has contracted for an engagement to prepare the entity’s financial statements, agreeing to the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present.
2. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following:
    - a. The objective of the engagement
    - b. The responsibilities of management set forth in paragraph .25 of AR-C section 60
    - c. The agreement with management that either:
      - each page of the financial statements will include a statement (legend) indicating that “no assurance” is provided on the financial statements, or
      - the accountant will be required to issue a disclaimer report that makes clear that no assurance is provided on the financial statements.
    - d. The responsibilities of the accountant
    - e. The limitations of the engagement to prepare financial statements
    - f. Identification of the applicable financial reporting framework for the preparation of financial statements
    - g. Whether the financial statements are to:
      - contain a known departure(s) from the applicable framework, or
      - omit substantially all disclosures required by the applicable financial reporting framework.
  3. The engagement letter or other suitable form of written agreement should be signed by both:
    - a. the accountant or the accountant’s firm, and
    - b. management or those charged with governance.

**Note:** The existing rules found in SSARS No. 19 require an accountant to obtain an understanding in writing of the terms and conditions of the engagement. However, SSARS No. 19 does not require that the engagement letter be signed by the accountant and the client. Now, SSARS No. 21 requires that the letter be signed by both the accountant and management or those charged with governance.

In lieu of an engagement letter, a more formal contract is another suitable form of written communication. The understanding with management regarding the services to be performed for engagements to prepare financial statements is required to be in a documented form. Accordingly, a verbal understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements.

### **Exhibit: Illustrative Engagement Letter—Preparation Engagement**

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The following is an example of an engagement letter for an accountant to prepare financial statements prepared in accordance with U.S. GAAP. This sample letter is extracted from AR-C 70 of SSARS No. 21 and modified by the author. This engagement letter is not authoritative but is intended as an illustration.

CPA Firm Letterhead

To the appropriate representative of ABC Company:(1)

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, and changes in stockholders' equity for the year then ended. These financial statements will not include a statement of cash flows and related notes to the financial statements.(2)

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services.(3)

We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

**Our Responsibilities**

The objective of our engagement is to prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

**Management Responsibilities**

The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARs:

- a. The selection of the financial reporting framework to be applied in the preparation of financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

The financial statements will not include a statement of cash flows and substantially all disclosures required by accounting principles generally accepted in the United States of America. You agree that the financial statements will clearly indicate that the statement of cash flows and substantially all required disclosures are omitted.

[If the accountant expects to issue a disclaimer report, instead of the preceding paragraph, the following may be added]:

*As part of our engagement, we will issue a disclaimer [report] that will state that the financial statements were not subjected to an audit, review or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.*

**Other relevant information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant or accountant's firm] (4)

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_ (4)

[Signed]  
[Name and title]

\_\_\_\_\_  
[Date]

- (1) The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons.
- (2) In most cases, the preparation of financial statements will omit both a statement of cash flows and substantially all disclosures. In such a situation, an additional sentence may be added stating:

*“These financial statements will not include a statement of cash flows and related notes to the financial statements.”*

If, instead, a statement of cash flows and substantially all disclosures are included, the first paragraph would read as follows:

*“You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, and changes in stockholders’ equity, and cash flows for the year then ended and the related notes to the financial statements.”*

- (3) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement letter. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (4) Engagement letter must be signed by both management and the accountant.

### **Illustrative Financial Statements—AR-C 70**

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On the following pages, the author has included examples of financial statements that encompass the preparation of financial statements standards under AR-C 70.

#### **Example 1: Preparation of GAAP Financial Statements—Full Set of Financial Statements and Disclosures**

**Facts:**

- An accountant is engaged to prepare a full set of financial statements and disclosures for XYZ Company.
- No schedule of operating expenses or other supplementary information is prepared.
- No compilation, review or audit engagement is performed on the financial statements.

**Conclusion:** A full set of financial statements would be prepared including all related notes.

In this example, the author has included only the balance sheet and income statement. A statement of cash flows and all related notes to financial statements should be presented.

XYZ Company  
Balance Sheets  
December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u> 		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

***No assurance is provided on these financial statements. or***

***These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.***



XYZ Company		
Statements of Income and Retained Earnings		
Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>
 <b><i>No assurance is provided on these financial statements. or</i></b>		
 <b><i>These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.</i></b>		

**Other statement and disclosures included but not presented here:**

Statement of cash flows  
All notes to financial statements

**Example 2: Preparation of Financial Statements—Disclaimer Report Issued—No Statement (Legend) on Financial Statement Pages**

**Facts:**

- Same facts as Example 1 except that the client does not place a legend on each page of the financial statements indicating: *“No assurance is provided on these financial statements”* or, *“These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.”*
- A disclaimer report is issued by the accountant because there is no legend on each page of the financial statements.

**Sample Disclaimer Report:**

To: Board of Directors and Management<sup>7</sup>  
XYZ Company

The accompanying financial statements of XYZ Company as of and for the years ended December 31, 20X6 and 20X5, were not subjected to an audit, review, or compilation engagement by me (us) and, accordingly, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

Signature of accounting firm or accountant  
Accountant's city and state

XYZ Company  
Balance Sheets  
December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

<sup>7</sup> There is no requirement that the accountant include a greeting/salutation in the disclaimer report. The author includes it because he believes it would be appropriate to include the salutation in an disclaimer report issued.

XYZ Company Statements of Income and Retained Earnings Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

**Other statements and disclosures included but not presented here:**

Statements of cash flows  
All notes to financial statements

**Observation—Example 2:** Notice in Example 2, a disclaimer report is issued because the “no assurance” legend is omitted from each page of the financial statements.

**Example 3: Preparation of Financial Statements—Special purpose framework (Tax Basis)**

**Facts:** An accountant is engaged to prepare a full set of financial statements and disclosures for XYZ Company. A tax basis framework is used.

**Conclusion:** A full set of financial statements would be prepared including all related notes, based on the tax basis of accounting.

In this example, the author has included only the balance sheet and income statement. All related notes to financial statements should be presented. A statement of cash flows would not be presented as it is not required unless GAAP financial statements are presented.

XYZ Company		
Balance Sheets— <b>Tax Basis (1)</b>		
December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
<b><i>No assurance is provided on these financial statements. or</i></b>		
<b><i>These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.</i></b>		

XYZ Company		
Statements of Income and Retained Earnings— <b>Tax Basis (1)</b>		
Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>
<b><i>No assurance is provided on these financial statements. or</i></b>		
<b><i>These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.</i></b>		

**Other disclosures included but not presented here:** All notes to financial statements would be included.

**Note:** In addition to a balance sheet and income statement, a full set of notes to financial statements would also be included. A statement of cash flows would not be required because tax basis financial statements do not require that a statement of cash flows be included.

- (1) When a special purpose framework is used, such as tax basis financial statements, a description of the framework must be presented either on the face of the financial statements or in the notes. In this example, one way in which it can be disclosed on the face of the financial statements is to include it in the suffix to the title, such as “balance sheet—tax basis.”

**Example 4: Preparation of GAAP Financial Statements—No Statement of Cash Flows and Substantially All Disclosures Omitted**

**Facts:**

- An accountant is engaged to prepare a GAAP balance sheet, income statement and schedule of operating expenses.
- The client does not want a statement of cash flows (GAAP departure) and omits substantially all disclosures.

**Conclusion:** GAAP statements should be prepared with the following:

- Statement (legend) on each page stating there is “no assurance”
- Disclosure (legend) on each page of the financial statements for the GAAP departure (no statement of cash flows)
- Disclosure (legend) on each page of the financial statements noting that substantially all disclosures are omitted.

XYZ Company			
Balance Sheets			
December 31, 20X6 and 20X5			
	<u>20X6</u>		<u>20X5</u>
<u>ASSETS</u>			
Cash	\$XX		\$XX
Accounts receivable	XX		XX
Property and equipment, net	XX		XX
Other assets	<u>XX</u>		<u>XX</u>
	<u>\$XX</u>		<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDER’S EQUITY</u>			
<u>Liabilities:</u>			
Accounts payable	\$XX		\$XX
Accrued expenses	XX		XX
Short-term notes payable	XX		XX
Long-term debt	<u>XX</u>		<u>XX</u>
	<u>XX</u>		<u>XX</u>
<u>Stockholders’ equity:</u>			
Common stock	XX		XX
Retained earnings	<u>XX</u>		<u>XX</u>
	<u>XX</u>		<u>XX</u>
	<u>\$XX</u>		<u>\$XX</u>
<b><i>No assurance is provided on these financial statements.</i></b>			
<b><i>The financial statements do not include a statement of cash flows.</i></b>			
<b><i>Substantially all disclosures required by accounting principles generally accepted in the United States are not included.</i></b>			

XYZ Company  
 Statements of Income and Retained Earnings  
 Years Ended December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

***No assurance is provided on these financial statements.***

***The financial statements do not include a statement of cash flows.***

***Substantially all disclosures required by accounting principles generally accepted in the United States are not included.***

XYZ Company  
Schedules of Operating Expenses  
Years Ended December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
Rent	\$XX	\$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

***No assurance is provided on these financial statements.***

***The financial statements do not include a statement of cash flows.***

***Substantially all disclosures required by accounting principles generally accepted in the United States are not included.***

**Observation:** Example 4 represents what is likely the typical format for a preparation of financial statements engagement under AR-C 70. In the example, the accountant prepares a balance sheet, income statement and schedule of operating expenses, but no statement of cash flows and no disclosures.

AR-C 70 states that there is no requirement to place any legends on schedules of supplementary information. The author recommends that an accountant include on schedules of supplementary information (such as a schedule of operating expenses), the same legends that are required for financial statements.



**Example 5: Preparation of Tax Basis Financial Statements—No Statement of Cash Flows is Presented and Substantially All Disclosures Omitted**

**Facts:**

- An accountant is engaged to prepare financial statements for XYZ Company on the tax basis of accounting.
- The client does not want a statement of cash flows (GAAP departure) and omits substantially all disclosures.
- A schedule of operating expenses is included.

**Conclusion:** Tax basis financial statements would be prepared with the following:

- Statement (legend) on each page stating there is “no assurance.”
- Disclosure (legend) on each page of the financial statements noting that substantially all disclosures “ordinarily included” in tax basis financial statements are omitted.
- No disclosure (legend) is required for not having a statement of cash flows because such a statement is not required unless GAAP statements are issued.

XYZ Company		
Balance Sheets— <b>Tax Basis</b>		
December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
<u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable		
Accrued expenses	\$XX	\$XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>	<u>XX</u>	<u>XX</u>
Common stock		
Retained earnings	XX	XX
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <b><i>No assurance is provided on these financial statements.</i></b>  <b><i>Substantially all disclosures ordinarily included in financial statements prepared on the tax basis of accounting are not included.</i></b>		

XYZ Company		
Statements of Income and Retained Earnings— <b>Tax Basis</b>		
Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>
 <b><i>No assurance is provided on these financial statements.</i></b>		
 <b><i>Substantially all disclosures ordinarily included in financial statements prepared on the tax basis of accounting are not included.</i></b>		

XYZ Company		
Schedules of Operating Expenses— <b>Tax Basis</b>		
Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Rent	\$XX	\$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <b><i>No assurance is provided on these financial statements.</i></b>		
 <b><i>Substantially all disclosures ordinarily included in financial statements prepared on the tax basis of accounting are not included.</i></b>		

**Observation:** Because Example 5 represents tax basis financial statements, no statement of cash flows is required, although such a statement could be included in the set of financial statements. Thus, the fact that there is no statement of cash flows is not a departure that requires a legend on the bottom of each page of the financial statements.

**Is an accountant permitted to use a disclaimer report and include a legend on each page of the financial statements stating “See Disclaimer Report”?**

Some accountants are uncomfortable with issuing prepared financial statements without a report. Therefore, they want to issue a disclaimer report as the standard format to performing a preparation engagement. Yet, SSARS No. 21 states that a disclaimer (report) is a default that is used when the financial statements do not include a legend such as “no assurance is provided on these financial statements.” Under the SSARS No. 21 requirements, an accountant issues a disclaimer report in instances in which he or she does not include a “no assurance” legend on each page of the financial statements. That means that the financial statements lack any form of legend that addresses the degree of responsibility. This scenario concerns many accountants who are uncomfortable with any financial statements being issued that have no legend on each page of the financial statements.

The question is whether an accountant is permitted to issue a disclaimer report and add a legend onto each page of the financial statements such as: “See Disclaimer Report.” or “See Accountant’s Disclaimer Report.” SSARS No. 21 is silent on the matter. Therefore, the author believes there is nothing that precludes an accountant from adding a “See Disclaimer Report” or “See Accountant’s Disclaimer Report” legend while also including a disclaimer report.

In such an instance, the real question is why the accountant doesn’t simply issue a compilation report instead of the disclaimer report.

For some accountants who might perform only preparation of financial statement engagements, changing to a compilation engagement means the accountant would be subject to peer review. Instead, by issuing preparation of financial statement engagements only, the accountant is most likely not subject to peer review.

Following is a nonauthoritative example of a situation in which an accountant chooses to issue a disclaimer report and adds a legend to each page of the financial statements “See Disclaimer Report.”

**Example 6: Preparation of Financial Statements–Disclaimer Report Issued—Disclaimer Legend on Financial Statement Pages**

**Facts:**

- No legend is presented on each page of the financial statements indicating: “No assurance is provided on these financial statements.”
- A disclaimer report is issued because the “no assurance” legend is omitted from each page of the financial statements.
- Accountant elects to add a legend stating “See Accountant’s Disclaimer Report.”
- There is no statement of cash flows and substantially all disclosures are omitted.

Board of Directors and Management  
XYZ Company

The accompanying financial statements of XYZ Company as of and for the years ended December 31, 20X6 and 20X5, were not subjected to an audit, review, or compilation engagement by me (us) and, accordingly, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

Signature of accounting firm or accountant  
Accountant’s city and state

XYZ Company  
Balance Sheets  
December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

***See Accountant's Disclaimer Report.***

***The financial statements do not include a statement of cash flows.***

***Substantially all disclosures required by accounting principles generally accepted in the United States are not included.***

XYZ Company  
 Statements of Income and Retained Earnings  
 Years Ended December 31, 20X6 and 20X5

Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

***See Accountant’s Disclaimer Report.***

***The financial statements do not include a statement of cash flows.***

***Substantially all disclosures required by accounting principles generally accepted in the United States are not included.***

XYZ Company  
 Schedules of Operating Expenses  
 Years Ended December 31, 20X6 and 20X5

	<u>20X6</u>	<u>20X5</u>
Rent	\$XX	\$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

***See Accountant’s Disclaimer Report.***

***The financial statements do not include a statement of cash flows.***

***Substantially all disclosures required by accounting principles generally accepted in the United States are not included.***

## Preparation of Personal Financial Statements

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### **Is an accountant permitted to perform a preparation of financial statements engagement under AR-C 70 on a prescribed form?**

Currently, SSARS No. 3 permits an accountant to issue a compilation report on a prescribed form financial statement such as a bank's preprinted personal financial statement. SSARS No. 3 offers a specific compilation report format for reporting on a prescribed form. SSARS No. 21 supersedes SSARS No. 3 so that there is no longer any formal guidance for reporting on a prescribed form.

A prescribed form is a standard preprinted form designed or adopted by the body to which it is to be submitted, such as a bank financial statement. Examples may include a financial statement on a bank's preprinted form.

The question is whether an accountant is permitted to perform a preparation of financial statements engagement on a bank's prescribed form personal financial statement.

The answer is that nothing within SSARS No. 21 precludes an accountant from performing a preparation of financial statements engagement on a bank's prescribed form personal financial statement or, for that matter, a GAAP personal financial statement.

If such an engagement is performed, the accountant must follow the rules found in AR-C 70 which, to repeat, follow:

1. Each page of the prescribed form personal financial statement must state, "*no assurance is provided on these financial statements*" or similar language.
2. If the client does not wish to add the "*no assurance*" legend, the accountant must attach a disclaimer report.
3. The accountant must follow the preconditions found in AR-C 60 general conditions, as well as the overall performance requirements found in AR-C 70.
4. If the prescribed form has GAAP departures, those departures must be disclosed in a legend on each page of the prescribed form, or in a footnote.
5. If substantially all disclosures are omitted, a legend noting that fact must be included on each page of the prescribed form or in a note.

### **May prescribed form financial statements include departures from GAAP?**

In general, a prescribed form financial statement has all of the information and disclosures that are needed for the end user. However, that information and disclosures may not satisfy the disclosures required by GAAP.

In particular, ASC 274, *Personal Financial Statements* (formerly SOP 82-1) establishes accounting standards for GAAP-basis personal financial statements. The statement:

1. Requires that assets be stated at their estimated current values, and liabilities at their estimated current amounts. The costs of disposal of assets, if material, should be deducted in computing current values.
2. A statement of financial condition is required while a statement of changes in net worth is optional.
3. ASC 274 requires that a hypothetical estimated income tax liability be calculated and presented in the liability section of the statement of net worth as follows:

Estimated current value of net assets	\$XX
Tax basis of net assets	<u>XX</u>
Hypothetical gain	XX
Tax rate (s)	<u>XX%</u>
Estimated income tax liability on difference between value and tax basis of net assets	*\$XX
* Presented as liability on the statement of financial condition	

4. ASC 274 requires disclosures.

Most bank prescribed-form personal financial statements include a statement of net worth and are measured at current value or fair value. The key GAAP departure, however, is that a prescribed form personal financial statement usually does not include the estimated tax liability.

With respect to a preparation engagement, there is no report in which to reference that the prescribed form has a GAAP departure(s). Thus, AR-C 70 states that any GAAP departures must be disclosed either on the face of the financial statements or in a note.

In performing a preparation of financial statements engagement on a prescribed form, the accountant will most likely want to disclose any GAAP departures on the face of the financial statements and avoid having to disclose it in a separate footnote.

**Example 1:** Mary Jones, CPA performs a preparation of financial statements engagement on John Smith’s prescribed form personal financial statement for the year ended December 31, 2015. A compilation, review or audit engagement is not performed.

The only GAAP departure in the prescribed form personal financial statement is that the personal financial statement does not include an “estimated tax liability” that is required under GAAP for personal financial statements. Substantially all GAAP disclosures are omitted.

**Conclusion:** Mary should follow the rules for a preparation of financial statements engagement under AR-C 70.

1. The accountant must follow the preconditions found in AR-C 60 general conditions, as well as the overall performance requirements found in AR-C 70.
2. Each page of the prescribed form personal financial statement must state:

*“No assurance is provided on these financial statements.”*

If the client does not wish to add the “no assurance” legend, the accountant must attach a disclaimer report.

3. Each page of the prescribed form personal financial statement should state that there is a GAAP departure for not including an “estimated tax liability.”
4. Each page of the prescribed form should include a legend stating that substantially all disclosures required by GAAP are not included.

On the following pages, the author provides sample personal financial statements on a prescribed bank form, prepared under the AR-C 70 rules.



**Never Loan Bank**  
*WE SAY NEVER WITH A SMILE*

PERSONAL FINANCIAL STATEMENT		CONFIDENTIAL	
As of: 12-31-15	<p><b>IMPORTANT: INSTRUCTIONS TO APPLICANT</b></p> <p>Read directions before completing Financial Statement. Please check appropriate box</p> <p><input checked="" type="checkbox"/> Individual credit—If relying on your own income and assets and not the income and assets of a spouse or another person as a basis for Extension or repayment or credit, complete the Financial Statement below.</p> <p><input type="checkbox"/> Joint Credit      If applying for joint credit or for individual credit relying on income or assets of a spouse or another person for extension and repayment of credit requested,</p> <p><input type="checkbox"/> Individual relying upon income or assets of spouse or other person.      Complete the Financial Statement below. Include information about income, assets, and liabilities of the spouse or other person. Both Applicant and Spouse or Co-Applicant sign this statement.</p>		
Name: John Smith			
Address: 112 Jones Blvd			
City/Town: Boston      State: MA			
Employer/position: Big Dog Manufacturing			
Date of birth: 04-04-52			
Social security number: 023-33-4435			
Spouse name:			
Address:			
City/Town:      State:			
Employer/position:			
Date of birth:			
Social security number:			
Please do not leave any questions unanswered. Use "no" or "none" where necessary.			
FINANCIAL CONDITION AS OF December 31, 2015			
Assets	<i>In Even Dollars</i>	Liabilities and Net Worth	<i>In Even Dollars</i>
Cash on hand and in Banks—See Schedule A	\$ 200,000	Notes Payable: This Bank—See Schedule A	\$1,000,000
Government Securities—See Schedule B		Notes Payable: Other Institutions—See Schedule A	
Listed Securities—See Schedule B	3,800,000	Notes Payable—Relatives	
Unlisted Securities—See Schedule B		Notes Payable—Others	
Other Equity Interests—See Schedule B		Accounts and Bills Due	25,000
Accounts and Notes Receivable		Unpaid Taxes	
Real Estate Owned—See Schedule C	4,000,000	Real Estate Mortgages Payable—See Schedule C or D	1,300,000
Mortgages and Land Contracts Receivable—See Schedule D		Land Contracts Payable—See Schedule C or D	
Cash Value Life Insurance—See Schedule E		Life Insurance Loans—See Schedule E	
Other Assets: Itemize	150,000	Other Liabilities: Itemize	
Furniture and fixtures	50,000	Miscellaneous payables	75,000
		<b>TOTAL LIABILITIES</b>	<b>\$2,400,000</b>
		<b>NET WORTH</b>	<b>\$5,800,000</b>
<b>TOTAL ASSETS</b>	<b>\$8,200,000</b>	<b>TOTAL LIABILITIES AND NET WORTH</b>	<b>\$8,200,000</b>
<p><b>No assurance is provided on these financial statements.</b></p> <p><b>The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.</b></p> <p><b>Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.</b></p>			



Chapter 3 – AR-C Section 70

<i>Sources of Income</i>	<i>In Even Dollars</i>	<i>General Information</i>
Salary	\$	Employer: Smith, Smith and Alfonzo, Attorneys at Law
Bonus and Commissions		Position or Profession: Partner No. Years 25
Dividends	200,000	Employer's Address: 10 State St., Boston, MA
Real Estate Income	170,000	Phone No. 617-628-4400
*Other Income: Itemize		Partner, officer or owner in any other venture? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes
Partnership income K-1	250,000	If so, explain:
<b>TOTAL</b>	<b>\$620,000</b>	

\*Alimony, child support or separate maintenance payments need not be disclosed unless relied upon as a basis for extension of credit. If disclosed, payments received under  court order  written agreement  oral understanding.

Are any assets pledged?  No  Yes  
Detail in Schedule A and C

Income taxes settled through (Date) 2011

<i>Contingent Liabilities</i>	<i>In Even Dollars</i>	<i>General Information (continued)</i>
As endorser, co-maker or guarantor	\$	Are you a defendant in any suits or legal action? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes
On leases		If so, explain:
Legal claims		Have you ever taken bankruptcy? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes
Provision for federal income taxes	100,000	If so, explain:
Other special debt, e.g., recourse or repurchase liability		Do you have a will? <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes
		Do you have a trust? <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes
<b>TOTAL</b>	<b>\$100,000</b>	Number of dependents 2 Ages 16 and 19

**Schedule A: Banks, Brokers, Savings & Loan Association, Finance Companies or Credit Unions.** List here the names of all the institutions at which you maintain a deposit account and/or where you have obtained loans.

<i>Name of Institution</i>	<i>Name on Account</i>	<i>Balance on Deposit</i>	<i>High Credit</i>	<i>Amount Owing</i>	<i>Monthly Payment</i>	<i>Secured by What Assets</i>
Bank of America	John Smith	\$150,000	\$0	\$0	\$0	\$0
TD Bank	John Smith	50,000	0	0	0	0
No Loan Bank	John Smith			1,000,000	4,500	0
	<b>TOTAL</b>	<b>\$200,000</b>	<b>TOTAL</b>	<b>\$1,000,000</b>	<b>\$4,500</b>	<b>\$0</b>

**Schedule B: U.S. Governments, Stocks (Listed & Unlisted), Bonds (Gov't & Comm.), and Partnership Interests (General & Ltd.)**

<i>Number of</i>	<i>Indicate:</i>	<i>In Name of</i>	<i>*Market Value</i>	<i>Pledged</i>	
<i>Shares, Face Value (Bonds), or % of Ownership</i>	<i>1. Agency or name of company issuing security or name of partnership 2. Type of investment or equity classification 3. Number of shares, bonds or % of ownership held 4. Basis of valuation*</i>			<i>Yes (✓)</i>	<i>No (✓)</i>
10,300	IBM	John Smith	400,000		X
18,000	Microsoft	John Smith	1,800,000		X
20,000	Ford	John Smith	1,000,000		X
10,000	General Electric	John Smith	600,000		X
		<b>TOTAL</b>	<b>3,800,000</b>		

\*If unlisted security or partnership interest, provide current financial statements to support basis for valuation.

**No assurance is provided on these financial statements.**

**The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.**

**Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.**

Chapter 3 – AR-C Section 70

<b>Schedule C: Real Estate Owned (and related debt, if applicable)</b>							
Description of Property or Address	Title in Name of	Date Acquired	Cost + Improvements	Present Mkt. Value	Mortgage or Land Contract Payable		
					Bal. Owing	Mo. Payt.	Holder
130 Reginald St, Boston, MA	John Smith	2005	\$1,500,000	\$3,000,000	\$1,000,000	\$5,000	BOA
Residence: 112 Jones Blvd, Boston, MA	John and Mary Smith	1990	130,000	1,000,000	300,000	1,500	BOA
		<b>TOTAL</b>		\$4,000,000	\$1,300,000	\$6,500	

  

<b>Schedule D: Real Estate: Mortgages &amp; Land Contracts Receivable (and related debt, if applicable)</b>							
Description of Property or Address	Title in Name Of	Date Acquired	Balance Receivable	Monthly Payment	Mortgage or Land Contract Payable		
					Bal. Owing	Mo. Payt.	Holder
		<b>TOTAL</b>					

  

<b>Schedule E: Life Insurance Carried</b>				
Name of Company	Face Amount	Cash Surrender Value	Loans	Beneficiary
	<b>TOTAL</b>			

I/we have carefully read and submitted the foregoing information provided on all three pages of this statement to the Bank named above. The information is presented as a true and accurate statement of my/our financial condition on the date indicated. This statement is provided for the purpose of obtaining and maintaining credit with said Bank. I/we agree that if any material change(s) occur(s) in my/our financial condition that I/we will immediately notify said Bank of said change(s) and unless said Bank is so notified it may continue to rely upon this financial statement and the representations made herein as a true and accurate statement of my/our financial condition.

I/we authorize the Bank to make whatever credit inquiries it deems necessary in connection with this financial statement. I/we authorize and instruct any person or consumer reporting agency to furnish to the Bank any information that it may have or obtain in response to such credit inquiries.

**I/we also hereby certify that no payment requirements listed herein are delinquent or in default except as follows; if "NONE" so state.**

**I/we fully understand that it is a federal crime punishable by fine or imprisonment or both to knowingly make any false statements concerning any of the above facts.**

Applicant's Signature \_\_\_\_\_ Date Signed \_\_\_\_\_

Spouse's or Co-Applicant's Signature \_\_\_\_\_ Date Signed \_\_\_\_\_

**No assurance is provided on these financial statements.**

**The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.**

**Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.**

**Example 2:** Same facts as Example 1 except that the client does not wish to place a “*no assurance*” legend on each page of the personal financial statements.

**Conclusion:** In accordance with SSARS No. 21, the accountant must attach a disclaimer report.

John Smith

The accompanying financial statements of John Smith as of and for the year ended December 31, 2015, were not subjected to an audit, review, or compilation engagement by me. Accordingly, I do not express an opinion, a conclusion, nor provide any assurance on them.

Mary Jones, CPA  
Boston, Massachusetts



**Never Loan Bank**  
*WE SAY NEVER WITH A SMILE*

PERSONAL FINANCIAL STATEMENT		CONFIDENTIAL	
As of: 12-31-15	<p><b>IMPORTANT: INSTRUCTIONS TO APPLICANT</b></p> <p>Read directions before completing Financial Statement. Please check appropriate box</p> <p><input checked="" type="checkbox"/> Individual credit—If relying on your own income and assets and not the income and assets of a spouse or another person as a basis for Extension or repayment or credit, complete the Financial Statement below.</p> <p><input type="checkbox"/> Joint Credit      If applying for joint credit or for individual credit relying on income or assets of a spouse or another person for extension and repayment of credit requested,</p> <p><input type="checkbox"/> Individual relying upon income or assets of spouse or other person.      Complete the Financial Statement below. Include information about income, assets, and liabilities of the spouse or other person. Both Applicant and Spouse or Co-Applicant sign this statement.</p>		
Name: John Smith			
Address: 112 Jones Blvd			
City/Town: Boston      State: MA			
Employer/position: Big Dog Manufacturing			
Date of birth: 04-04-52			
Social security number: 023-33-4435			
Spouse name:			
Address:			
City/Town:      State:			
Employer/position:			
Date of birth:			
Social security number:			
Please do not leave any questions unanswered. Use "no" or "none" where necessary.			
FINANCIAL CONDITION AS OF December 31, 2015			
Assets	In Even Dollars	Liabilities and Net Worth	In Even Dollars
Cash on hand and in Banks—See Schedule A	\$ 200,000	Notes Payable: This Bank—See Schedule A	\$1,000,000
Government Securities—See Schedule B		Notes Payable: Other Institutions—See Schedule A	
Listed Securities—See Schedule B	3,800,000	Notes Payable—Relatives	
Unlisted Securities—See Schedule B		Notes Payable—Others	
Other Equity Interests—See Schedule B		Accounts and Bills Due	25,000
Accounts and Notes Receivable		Unpaid Taxes	
Real Estate Owned—See Schedule C	4,000,000	Real Estate Mortgages Payable—See Schedule C or D	1,300,000
Mortgages and Land Contracts Receivable—See Schedule D		Land Contracts Payable—See Schedule C or D	
Cash Value Life Insurance—See Schedule E		Life Insurance Loans—See Schedule E	
Other Assets: Itemize	150,000	Other Liabilities: Itemize	
Furniture and fixtures	50,000	Miscellaneous payables	75,000
		<b>TOTAL LIABILITIES</b>	<b>\$2,400,000</b>
		<b>NET WORTH</b>	<b>\$5,800,000</b>
<b>TOTAL ASSETS</b>	<b>\$8,200,000</b>	<b>TOTAL LIABILITIES AND NET WORTH</b>	<b>\$8,200,000</b>
<p><b><i>The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.</i></b></p> <p><b><i>Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.</i></b></p>			

Chapter 3 – AR-C Section 70

<i>Sources of Income</i>		<i>In Even Dollars</i>	<i>General Information</i>				
Salary		\$	Employer: Smith, Smith and Alfonzo, Attorneys at Law				
Bonus and Commissions			Position or Profession: Partner		No. Years 25		
Dividends		200,000	Employer's Address: 10 State St., Boston, MA				
Real Estate Income		170,000	Phone No. 617-628-4400				
*Other Income: Itemize			Partner, officer or owner in any other venture? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes				
Partnership income K-1		250,000	If so, explain:				
<b>TOTAL</b>		<b>\$620,000</b>					
*Alimony, child support or separate maintenance payments need not be disclosed unless relied upon as a basis for extension of credit. If disclosed, payments received under <input type="checkbox"/> court order <input type="checkbox"/> written agreement <input type="checkbox"/> oral understanding.			Are any assets pledged? <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes Detail in Schedule A and C				
			Income taxes settled through (Date) 2011				
<i>Contingent Liabilities</i>		<i>In Even Dollars</i>	<i>General Information (continued)</i>				
As endorser, co-maker or guarantor		\$	Are you a defendant in any suits or legal action? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes				
On leases			If so, explain:				
Legal claims			Have you ever taken bankruptcy? <input checked="" type="checkbox"/> No <input type="checkbox"/> Yes				
Provision for federal income taxes		100,000	If so, explain:				
Other special debt, e.g., recourse or repurchase liability			Do you have a will? <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes				
			Do you have a trust? <input type="checkbox"/> No <input checked="" type="checkbox"/> Yes				
<b>TOTAL</b>		<b>\$100,000</b>	Number of dependents 2 Ages 16 and 19				
<b>Schedule A: Banks, Brokers, Savings &amp; Loan Association, Finance Companies or Credit Unions.</b> List here the names of all the institutions at which you maintain a deposit account and/or where you have obtained loans.							
<i>Name of Institution</i>	<i>Name on Account</i>	<i>Balance on Deposit</i>	<i>High Credit</i>	<i>Amount Owing</i>	<i>Monthly Payment</i>	<i>Secured by What Assets</i>	
Bank of America	John Smith	\$150,000	\$0	\$0	\$0	\$0	
TD Bank	John Smith	50,000	0	0	0	0	
No Loan Bank	John Smith			1,000,000	4,500	0	
<b>TOTAL</b>		<b>\$200,000</b>	<b>TOTAL</b>	<b>\$1,000,000</b>	<b>\$4,500</b>	<b>\$0</b>	
<b>Schedule B: U.S. Governments, Stocks (Listed &amp; Unlisted), Bonds (Gov't &amp; Comm.), and Partnership Interests (General &amp; Ltd.)</b>							
<i>Number of</i>	<i>Indicate:</i>				<i>Pledged</i>		
<i>Shares, Face Value (Bonds), or % of Ownership</i>	<i>1. Agency or name of company issuing security or name of partnership 2. Type of investment or equity classification 3. Number of shares, bonds or % of ownership held 4. Basis of valuation*</i>			<i>In Name of</i>	<i>*Market Value</i>	<i>Yes (✓)</i>	<i>No (✓)</i>
10,300	IBM			John Smith	400,000		X
18,000	Microsoft			John Smith	1,800,000		X
20,000	Ford			John Smith	1,000,000		X
10,000	General Electric			John Smith	600,000		X
				<b>TOTAL</b>	<b>3,800,000</b>		
*If unlisted security or partnership interest, provide current financial statements to support basis for valuation.							
<p><b>The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.</b></p> <p><b>Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.</b></p>							

Chapter 3 – AR-C Section 70

<b>Schedule C: Real Estate Owned (and related debt, if applicable)</b>							
Description of Property or Address	Title in Name of	Date Acquired	Cost + Improvements	Present Mkt. Value	Mortgage or Land Contract Payable		
					Bal. Owing	Mo. Payt.	Holder
130 Reginald St, Boston, MA	John Smith	2005	\$1,500,000	\$3,000,000	\$1,000,000	\$5,000	BOA
Residence- 112 Jones Blvd, Boston, MA	John and Mary Smith	1990	130,000	1,000,000	300,000	1,500	BOA
		<b>TOTAL</b>		\$4,000,000	\$1,300,000	\$6,500	

  

<b>Schedule D: Real Estate: Mortgages &amp; Land Contracts Receivable (and related debt, if applicable)</b>							
Description of Property or Address	Title in Name Of	Date Acquired	Balance Receivable	Monthly Payment	Mortgage or Land Contract Payable		
					Bal. Owing	Mo. Payt.	Holder
		<b>TOTAL</b>					

  

<b>Schedule E: Life Insurance Carried</b>				
Name of Company	Face Amount	Cash Surrender Value	Loans	Beneficiary
	<b>TOTAL</b>			

I/we have carefully read and submitted the foregoing information provided on all three pages of this statement to the Bank named above. The information is presented as a true and accurate statement of my/our financial condition on the date indicated. This statement is provided for the purpose of obtaining and maintaining credit with said Bank. I/we agree that if any material change(s) occur(s) in my/our financial condition that I/we will immediately notify said Bank of said change(s) and unless said Bank is so notified it may continue to rely upon this financial statement and the representations made herein as a true and accurate statement of my/our financial condition.

I/we authorize the Bank to make whatever credit inquiries it deems necessary in connection with this financial statement. I/we authorize and instruct any person or consumer reporting agency to furnish to the Bank any information that it may have or obtain in response to such credit inquiries.

**I/we also hereby certify that no payment requirements listed herein are delinquent or in default except as follows; if "NONE" so state.**

**I/we fully understand that it is a federal crime punishable by fine or imprisonment or both to knowingly make any false statements concerning any of the above facts.**

Applicant's Signature \_\_\_\_\_ Date Signed \_\_\_\_\_

Spouse's or Co-Applicant's Signature \_\_\_\_\_ Date Signed \_\_\_\_\_

**The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.**

**Substantially all disclosures required by accounting principles generally accepted in the United States of America are not included.**

**Observation:** Notice that Example 2 does not include a “no assurance” legend on each page of the financial statements. AR-C 70 of SSARS No. 21 states that if a “no assurance” legend is not included on each page of the financial statements, the accountant must include a disclaimer report.

Notice also that there is a legend that states: “*The personal financial statement does not include an estimated tax liability as required by accounting principles generally accepted in the United States of America.*” Because there is a GAAP departure in the personal financial statements (no estimated tax liability is recorded), that departure must be disclosed either on each page of the personal financial statements or in an accompanying note.

## Review Questions

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1. To which of the following engagements do the standards found in AR-C 70 apply?
  - A. Preparation of financial statements by an accountant in industry and there is no other engagement performed on those financial statements
  - B. Preparation of financial statements by an accountant in public practice and the accountant is also engaged to perform an audit on those same financial statements
  - C. Preparation of financial statements by an accountant in public practice and the accountant is not engaged to perform any other engagement on those same financial statements
  - D. Preparation of financial statements by an accountant in industry and the accountant is also performing a review engagement on those same financial statements
  
2. Ivan the accountant is preparing financial statements for a client. Which of the following is an example of a situation in which Ivan's preparation of financial statements engagement would be subject to the rules found in AR-C 70?
  - A. Preparation of financial statements solely for Ivan to submit to the IRS with the tax return
  - B. Preparation of financial statements that will be part of a business valuation service
  - C. Preparation of financial statements by Ivan prior to another CPA firm performing a review engagement on the same financial statements
  - D. Preparation of financial statements that will be included as part of a personal financial plan that Ivan will prepare for his client
  
3. Carla Carlson CPA is preparing financial statements and also performing a review engagement on the same financial statements. Which standards should Carla follow?
  - A. AR-C 70 for the preparation engagement, and AR-C 90 for the review engagement
  - B. AR-C 70 for the preparation engagement and AR-C 60 for the review engagement
  - C. AR-C 70 for both engagements
  - D. AR-C 90 for both engagements
  
4. Big Jimmy Johnston, CPA is hired to perform a preparation of financial statements engagement for 20X5. Jimmy completes the engagement and six months later is asked to perform a compilation engagement for the same 20X5 period. Which of the following is correct based on the author's opinion?
  - A. The author suggests that the preparation engagement and compilation engagement should be treated as two separate engagements
  - B. The author suggests that both engagements should be treated as a preparation engagement under AR-C 70
  - C. The author suggests that both engagements should be treated as a compilation engagement under AR-C 80
  - D. The author suggests that the two engagements are not covered by the SSARs
  
5. Which of the following is not a basis of accounting included under the special purpose framework?
  - A. Cash basis
  - B. Tax basis
  - C. Contractual basis
  - D. Accrual basis
  
6. One of the ways in which the definition of tax basis has changed under the new SAS is that the new definition does what?
  - A. Removes the "expects to use" from the definition
  - B. Removes the term "substantial support" from the definition
  - C. Adds the term "federal" to the definition
  - D. Makes no changes to the previous SAS No. 62 definition



7. Which of the following is correct with respect the rules for a preparation of financial statements engagement under AR-C 70?
  - A. The accountant must be independent
  - B. A special report must be issued
  - C. An engagement letter must be signed by management but not the accountant
  - D. The financial statements may be issued to the client or third party
  
8. An accountant performs a preparation of financial statements engagement under AR-C 70. The accountant obtains information from management to prepare the financial statements. Which of the following properly identifies the accountant’s responsibility with respect to the information obtained from management?
  - A. The accountant is required to verify the accuracy of the information
  - B. The accountant is required to verify the completeness of the information
  - C. The accountant is required to verify the completeness, but not the accuracy of the information
  - D. The accountant is not required to verify the accuracy or completeness of the information
  
9. In a preparation of financial statements engagement, which of the following is an appropriate legend to place on each page of the financial statements?
  - A. *“See Accountant’s Preparation Report”*
  - B. *“No assurance is provided on these financial statements”*
  - C. *“See Notes to Financial Statement”*
  - D. *“See Independent Accountant’s Report”*
  
10. Sophia Rapallo is an accountant who is hired to prepare financial statements for her client. The client wants her to prepare her financial statements using the tax basis, which is a special purpose framework. What must the accountant do with respect to the special purpose framework?
  - A. She should include a description of the framework in the accountant’s report
  - B. She should include a description of the framework in the notes to financial statements but not on the face of the financial statements
  - C. She should include the description of the framework on the face of the financial statements or in the notes to financial statements
  - D. She should do nothing as no modification is required
  
11. Elaine Liberman is performing a preparation of financial statements engagement under AR-C 70. Elaine discovers a significant error that makes the financial statements inaccurate. How should Elaine handle this profound discovery of a significant error?
  - A. Elaine should disregard the discovery; there is no requirement to verify or correct errors in a preparation engagement
  - B. Elaine should bring the error to the attention of the third-party users
  - C. Elaine should bring the error to the attention of management and request from management any additional information and/or corrected information
  - D. Elaine must modify her preparation report to identify the error, if it is material
  
12. Joseph Coatman is performing a preparation of financial statements engagement under AR-C 70. The financial statements omit substantially all disclosures. Which of the following is the correct way in which Joseph should deal with the omission of disclosures?
  - A. The disclosure of the omission should be made on the face of the financial statements or in a note to the financial statement
  - B. The disclosure of the omission should be made in a note to the financial statements
  - C. Nothing has to be done by Joseph
  - D. Disclosure must be made in the preparation report

13. An accountant is performing a preparation of financial statements engagement under AR-C 70 on a client's financial statements. There is no statement of cash flows and substantially all disclosures are omitted. Which of the following identifies the legends that should be presented on each page of the financial statements?
- A. There should be three legends
  - B. There should be two legends
  - C. There should be one legend
  - D. No legends are required
14. An accountant is preparing tax basis financial statements under AR-C 70. Substantially all disclosures are omitted. Which of the following is correct?
- A. A disclosure is required stating that substantially all disclosures required are omitted
  - B. A disclosure is required stating that substantially all disclosures ordinarily included are omitted
  - C. No disclosure is required
  - D. A disclosure is required stating that substantially all disclosures generally considered important are omitted
15. Which of the following is an item that should be documented in a preparation of financial statements engagement under AR-C 70?
- A. A copy of the financial statements
  - B. A copy of the accountant's preparation report
  - C. Preparation checklist
  - D. A management representation letter

## Review Answers

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1.
  - A. Incorrect. A preparation of financial statements engagement under AR-C 70 requires the accountant to be in public accounting, not industry, making the answer incorrect. If the accountant were in public accounting, the fact that there is no other engagement performed on those financial statements would make the engagement subject to the AR-C 70 standards.
  - B. Incorrect. In order for the preparation of financial statements engagement to be covered by AR-C 70, not only must the accountant be in public practice, but there cannot be any compilation, review or audit engagement performed on those same financial statements. In this case, an audit is performed. Thus, the answer is incorrect.
  - C. **Correct.** A preparation of financial statements engagement is covered by AR-C 70 if an accountant is in public practice and the accountant is not engaged to perform any other engagement on those same financial statements. The answer satisfies both of those requirements making the answer correct.
  - D. Incorrect. The answer is incorrect for two reasons. First, a preparation of financial statements engagement requires the accountant to be in public accounting, which is not the case in this example. Second, there can be no compilation, review or audit engagement performed on the same financial statements. In this example, a review engagement is being performed, thereby disqualifying the engagement for coverage under AR-C 70.
  
2.
  - A. Incorrect. If Ivan prepares financial statements for the sole purpose of submitting them to the IRS with the tax return, AR-C 70 states that such statements are not covered under AR-C 70.
  - B. Incorrect. AR-C 70 states that the preparation of financial statements that will be part of a business valuation service are not covered by AR-C 70.
  - C. **Correct.** AR-C 70 provides that if financial statements are prepared by an accountant prior to another CPA firm performing a compilation, review or audit engagement on the same financial statements, those financial statements are covered by the AR-C 70 standards. Thus, the answer is correct.
  - D. Incorrect. AR-C 70 states that the AR-C 70 rules do not apply if an accountant prepares financial statements that will be included as part of a personal financial plan. Thus, the answer is incorrect.
  
3.
  - A. Incorrect. When a preparation engagement is performed as part of a review engagement, the accountant does not bifurcate the rules into two sections. Instead, the review standards are following under AR-C 90 only.
  - B. Incorrect. AR-C 70 does not apply because a review is performed on the same financial statements. Moreover, AR-C 60 represents the general principles and not the rules for a review engagement.
  - C. Incorrect. The AR-C 70 standards apply only when a preparation engagement is performed and there is no compilation, review or audit engagement on the same financial statements. This is not the case in this example.
  - D. **Correct.** Because a preparation and also a review engagement are performed on the same financial statements, AR-C 70 states that the accountant should follow only the review standards found in AR-C 90.
  
4.
  - A. **Correct.** Because the two engagements are not performed at the same or similar time, the author suggests that the preparation engagement and compilation engagement should be treated as two separate engagements; one under AR-C 70 and the other under AR-C 80.
  - B. Incorrect. Under no circumstances does the author suggest that both engagements should be treated as a preparation engagement under AR-C 70. There is nothing within the SSARs that permits a preparation engagement and review engagement performed for the same financial statements to follow the standards under AR-C 70.

- C. Incorrect. If the engagements had been done either simultaneously or at a similar time, the standards found in AR-C 80 with respect to compilation engagements would be followed. In this example, there is a six-month lag time between performing the preparation engagement and the compilation engagement. Thus, performing both engagements under only the AR-C 80 compilation rules is not appropriate.
- D. Incorrect. Regardless of which set of standards are followed, both engagements are covered by the SSARSs making the answer incorrect.
5. A. Incorrect. The cash basis is an example of a basis under the special purpose framework.
- B. Incorrect. The tax basis is an example of a basis under the special purpose framework.
- C. Incorrect. The contractual basis is an example of a basis under the special purpose framework.
- D. **Correct.** The accrual basis of accounting, by itself, is not a basis included under the definition of a special purpose framework, making the answer correct.
6. A. **Correct.** The previous definition included the term “*expects to use*” which was removed from the definition.
- B. Incorrect. The term “*substantial support*” was removed from the definition of OCBOA, but not from the definition of tax basis.
- C. Incorrect. The term “*federal*” was not added to the definition.
- D. Incorrect. There were changes in the definition making the answer incorrect.
7. A. Incorrect. The accountant is not required to be independent to perform a preparation engagement under AR-C 70.
- B. Incorrect. In general, no report is required in a preparation of financial statements engagement.
- C. Incorrect. The engagement letter must be signed by both management and the accountant making the answer incorrect.
- D. **Correct.** AR-C 70 permits the prepared financial statements to be issued to the client or a third party without any restrictions.
8. A. Incorrect. AR-C 70 states that the accountant is not required to verify the accuracy of the information or, for that matter, gather evidence to express an opinion.
- B. Incorrect. Per AR-C 70, the accountant is not required to verify the completeness of the information.
- C. Incorrect. AR-C 70 is quite clear that the accountant is not required to verify the completeness or the accuracy of the information.
- D. **Correct.** AR-C 70 states that the accountant is not required to verify the accuracy or completeness of the information. Moreover, the accountant is not required to gather evidence to express an opinion or a conclusion on the statements.
9. A. Incorrect. The legend “*See Accountant’s Preparation Report*” is not appropriate primarily because there is no report.
- B. **Correct.** SSARS No. 21, AR-C 70 states that a legend should be included on each page of prepared financial statements similar to “*No assurance is provided on these financial statements*” or “*These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them.*”
- C. Incorrect. Although there is nothing to preclude an accountant from including a legend, “*See Notes to Financial Statements,*” AR-C 70 does not mention that legend. Further, in many cases in a preparation engagement, management may elect to omit substantially all disclosures so that there are no notes.
- D. Incorrect. AR-C 70 does not mention a legend such as “*See Independent Accountant’s Report.*” In particular, an accountant might not be independent in a preparation of financial statements engagement.

10. A. Incorrect. There is no report in a preparation of financial statements engagement in which to include a description.  
 B. Incorrect. Sophia has a choice of including a description either in the notes to financial statements or on the face of the financial statements making the answer incorrect.  
 C. **Correct.** AR-C 70 provides that a description must be provided either on the face of the financial statements or the notes to the financial statements making the answer correct.  
 D. Incorrect. A modification is required which is to provide a description of the tax basis special purpose framework. Thus, the answer is incorrect.
11. A. Incorrect. AR-C 70 does not permit Elaine to disregard the discovery. Instead, she must bring the matter to the attention of management.  
 B. Incorrect. There is no requirement to bring the error or any other notification to the attention of the users. The responsibility is to bring the error to the attention of management.  
 C. **Correct.** AR-C 70 is quite clear that if during a preparation engagement, the accountant becomes aware of incomplete, inaccurate, or otherwise unsatisfactory information, the accountant is required to bring that fact to the attention of management and request additional information or corrected information. Thus, the answer is correct.  
 D. Incorrect. There is no report so that there is no mechanism to identify the error in a report.
12. A. **Correct.** AR-C 70 requires that the disclosure of the omission be made either on the face of the financial statements or in a note, making the answer correct.  
 B. Incorrect. Joseph has the choice of presenting the disclosure of the omission either in a note to the financial statements or on the face of the financial statements.  
 C. Incorrect. AR-C 70 requires that a disclosure of the omission be made, making the answer incorrect.  
 D. Incorrect. There is no preparation report making the answer incorrect. If there is a disclaimer report, including the disclosure of the omission in that disclaimer report is not appropriate nor authorized by AR-C 70.
13. A. **Correct.** There should be three legends as follows: one for “*no assurance*,” one for the omission of a statement of cash flows, and one for substantially all disclosures no being included.  
 B. Incorrect. There is automatically one legend regarding the “*no assurance on the financial statements*.” Then, there must be one for the GAAP departure (no statement of cash flows) and one for the omission of disclosures. AR-C 70 requires legends/disclosures when there is a GAAP departure and substantially all disclosures are omitted. Thus, the total cannot be two legends.  
 C. Incorrect. The answer cannot be one legend if following the requirements of AR-C 70. There is one “*no assurance*” legend for all prepared financial statements. Because there is a GAAP departure and substantially all disclosures are omitted, there are two more disclosures/legends. Thus, one legend is incorrect.  
 D. Incorrect. There are three legends and certainly more than zero legends, making the answer incorrect. At a minimum, there is a “*no assurance*” legend. The fact that the accountant does not have a disclaimer report means that the “*no assurance*” legend is included. That “*no assurance*” legend, by itself, is at least one legend making the answer incorrect.
14. A. Incorrect. The term “*required*” should not be included in the disclosure because there are no formal disclosures identified for tax basis financial statements.  
 B. **Correct.** The term “*ordinarily included*” is appropriate because the tax basis does not have a codified list of required disclosures.  
 C. Incorrect. AR-C 70 requires that a disclosure/legend be made if substantially all disclosures are omitted.  
 D. Incorrect. The term “*generally considered*” is not used for tax basis financial statements. Instead, the term “*ordinarily included*” is used within AR-C 70.

15. A. **Correct.** AR-C 70 states that an accountant’s documentation should include a copy of the financial statements that the accountant prepared.
- B. Incorrect. There is no accountant’s preparation report making the answer incorrect. If there were a disclaimer report, it would be included. However, a “*preparation report*” is identified, not a “*disclaimer report*.”
- C. Incorrect. AR-C 70 does not conclude that a preparation checklist should be documented or even used, making the answer incorrect.
- D. Incorrect. AR-C 70 does not require that an accountant obtain a management representation letter in a preparation engagement. Thus, the answer is incorrect.

# Chapter 4

## AR-C Section 80

### *Compilation Engagements*

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#### Learning Objectives

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- Recognize the objective of a compilation engagement
- Identify a procedure that an accountant should perform in a compilation engagement
- Determine what phrase is added to the first paragraph of the new compilation report under AR-C 80
- Discern what disclosures must be made if management elects to omit substantially all disclosures from special purpose framework financial statements
- Recognize what an accountant should do when there is a GAAP departure in a compilation engagement
- Pinpoint the type of engagements found in SSARS No. 19 which SSARS No. 21 eliminates

#### Introduction

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AR-C 80, *Compilation Engagements*, is part of SSARS No. 21 and encompasses the new compilation standards that replace the existing compilation rules found in AR 80 of SSARS No. 19. Following is a summary of the key changes that the new AR-C 80 makes to the existing AR 80 compilation standards:

Element	Existing AR 80	New AR-C 80 (SSARS 21)
Definition of a compilation engagement	Assist management in presenting financial information in the form of financial statements	Apply accounting and financial reporting expertise to assist the client in the presentation of financial statements
Triggers for performing a compilation engagement	Accountant performs a compilation engagement if: <ul style="list-style-type: none"> <li>• accountant is engaged (hired) to perform a compilation engagement, or</li> <li>• accountant <u>submits</u> financial statements to client or third party<sup>1</sup></li> </ul>	Accountant performs a compilation engagement <u>only</u> if: <ul style="list-style-type: none"> <li>• accountant is engaged (hired) to perform compilation engagement</li> </ul> Existing submission trigger is eliminated
Preparation of financial statements	Preparation is <u>implicitly</u> part of a compilation engagement	Preparation is <u>explicitly separated</u> from a compilation engagement
Management use financial statements (SSARS 19)	Management use only financial statements <u>without a report</u> may be issued to management only  Accountant may restrict who receives financial statements	Management use only financial statements are eliminated  Compilation engagement always requires a report  Financial statements belong to management. Accountant cannot restrict who the financial statements are issued to <sup>2</sup>

<sup>1</sup> Existing definition of submission is when an accountant prepares financial statements and presents them to a client or a third party.

<sup>2</sup> The accountant can restrict who the financial statements are issued to by agreement with the client in an engagement letter.

Element	Existing AR 80	New AR-C 80 (SSARS 21)
Engagement letter	Engagement letter or written contract does not have to be signed	Engagement letter or written contract now must be signed by both the accountant and management
Independence	Lack of independence is disclaimed in report  Accountant may disclose reason(s) for lack of independence as long as all reasons are disclosed	Lack of independence is disclaimed in report  Accountant may disclose reason(s) for lack of independence as long as all reasons are disclosed
Report	<ul style="list-style-type: none"> <li>• Standard three paragraphs</li> <li>• Has title</li> <li>• Has salutation (addressee)</li> <li>• Management may elect to omit substantially all disclosures and statement of cash flows</li> <li>• Accountant’s city and state are not required</li> </ul>	<ul style="list-style-type: none"> <li>• Abbreviated one paragraph</li> <li>• No title</li> <li>• No salutation (addressee)</li> <li>• Management may elect to omit substantially all disclosures and statement of cash flows</li> <li>• Accountant’s city and state must be identified in the report<sup>3</sup></li> </ul>
Legend on financial statement pages	Legend required: either “See Accountant’s Compilation Report” or “See Independent Compilation Report”	Legend not required (optional): “See Accountant’s Compilation Report” “See Independent Compilation Report” or “See Accountant’s Report”
Income tax basis financial statements	OCBOA includes “income tax basis” financial statements	Special purpose framework includes “tax basis” financial statements
Emphasis-of-matter paragraph	Emphasis of matter paragraph permitted in certain cases	Carries over existing emphasis-of-matter paragraph and introduces new “other-matter” paragraph from auditing standards

## Effective Date

AR-C 80 is effective for compilations of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

## Scope of AR-C 80—Compilation Engagements

AR-C 80 provides the following scope for engagements that are covered under the compilation rules.

1. An engagement is subject to the compilation rules found in AR-C 80 only when the accountant is engaged to perform a compilation engagement (e.g., client hires the accountant to perform a compilation engagement).
  - The existing rules that a compilation engagement is required if an accountant submits financial statements is eliminated.
2. Historical or prospective financial information may be the subject of a compilation and includes the following:
  - A financial statement(s)
  - Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
  - Supplementary information

<sup>3</sup> Accountant's city and state may be listed on the accountant's letterhead.



- Required supplementary information
- Pro forma financial information
- Prospective financial information, including budgets, forecasts, or projections

**Observation:** Existing AR 80 provides that an accountant is required to perform a compilation engagement if he or she is hired to perform an engagement, or if he or she submits financial statements. An accountant submits financial statements if he or she prepares and presents financial statements to a client or third party. The original definition of “submission” was issued in 1978 as part of SSARS No. 1. Since that time, technology has affected how one determines whether financial statements have been “prepared” and whether they have been “presented.” For example, if an accountant makes adjusting entries to a QuickBooks file that automatically updates the financial statements, has the accountant prepared those financial statements? If the accountant prints out financial statements, has he or she prepared them? The challenge with the existing “submission” definition that is found in SSARS No. 19 is that it has not kept up with technological changes. It also does not necessarily reflect the needs of the client and end user. For example, an accountant may be forced to issue a compilation report solely because he or she has submitted financial statements even though the client has not engaged that accountant to do so. The new definition in AR-C 80 states that the only way an accountant performs a compilation engagement is if he or she is actually hired to do so.

## Objective of a Compilation Engagement

AR-C 80 states that the accountant’s objective in a compilation engagement is to do the following:

*“apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this standard (AR-C 80) without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.”*

A compilation engagement is separate from a preparation of financial statements engagement performed under AR-C 70 (a nonattest engagement).

**Note:** An accountant can be engaged to perform a compilation engagement and not prepare the financial statements. If the accountant is hired to both prepare financial statements and perform a compilation engagement on them, the engagement letter must identify both services separately.

## Definitions

AR-C 80 includes the following definitions related to compilation engagements.

**Applicable financial reporting framework:** The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

**Basic financial statements:** Financial statements excluding supplementary information and required supplementary information.

**Financial reporting framework:** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

**Generally accepted accounting principles (GAAP):** Reference to GAAP in SSARSs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the *Compliance With Standards Rule* (AICPA, *Professional Standards*, ET sec. 1.310.001), and the *Accounting Principles Rule* (AICPA, *Professional Standards*, ET sec. 1.320.001), of the AICPA Code of Professional Conduct.

**Management:** The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

**Misstatement:** A difference between the amount, classification, presentation, or disclosure of a reported financial item in the financial statements and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

**Required supplementary information:** Information that a designated accounting standard-setter requires to accompany an entity’s basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of that information have been established.

**Special purpose framework:** A financial reporting framework other than GAAP that is one of the following bases of accounting:

- **Cash basis:** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- **Tax basis:** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- **Regulatory basis:** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- **Contractual basis:** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- **Other basis:** A basis of accounting that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as other comprehensive bases of accounting (OCBOA).

**Supplementary information:** Financial information presented outside the financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework.

**Those charged with governance:** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

## Requirements—Compilation Engagements—AR-C 80

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An accountant who performs a compilation engagement, must comply with the following rules found in AR-C 80:

1. In addition to complying with AR-C 80, an accountant is required to comply with AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.
2. The accountant must determine whether the accountant is independent of the entity.

Note: In a compilation engagement, the accountant must determine whether he or she is independent. If not independent, the accountant is still permitted to perform the compilation engagement provided he or she notes the lack of independence in the compilation report.

3. Acceptance and continuance of client in compilation engagement:  
In order for an accountant to accept a compilation engagement with respect to an entity's financial statements, the accountant must meet certain preconditions as follows:
  - a. The accountant must satisfy general preconditions found in paragraphs .24 of the general conditions in AR-C 60, which state that the accountant should not accept an engagement to be performed in accordance with SSARs if:
    - (1) The accountant has reason to believe that relevant ethical requirements (including independence) will not be satisfied
    - (2) The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is not likely to be available or reliable, or
    - (3) The accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.
  - b. The accountant must satisfy certain general conditions found in paragraphs 25(a) and (b) of AR-C 60 general conditions which state that the accountant should:
    - (1) Determine whether preliminary knowledge of the engagement circumstances indicate that the ethical requirements regarding professional competence will be satisfied.
    - (2) Determine whether the financial reporting framework selected by management to be applied to the preparation of the financial statements is acceptable.  
Factors that are relevant to the accountant's determination that a financial reporting framework selected by management is acceptable include the following:
      - The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users), and
      - Whether law or regulation prescribes the applicable financial reporting framework.
  - c. The accountant should obtain the agreement of management (included in an engagement letter) as to the following:
    - (1) Obtain an agreement with management that it acknowledges and understands its responsibilities for the following found in paragraph .25(c.) of AR-C 60, general principles:
      - Selection of the financial reporting framework
      - Design, implementation, and maintenance of internal control
      - Preventing and detecting fraud
      - Ensuring that the entity complies with laws and regulations applicable to its activities
      - The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements, and
      - Providing the accountant with access to all relevant information and additional information that may be requested by the accountant, and unrestricted access to persons within the entity for necessary inquiry.

- (2) Obtain an agreement with management as to certain specific terms related to compilation engagements found in AR-C 80, as follows:

Management acknowledges and understands its responsibility:

- (a) for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements, and
- (b) to include the accountant's compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached

Additional terms for a special purpose framework engagement: If the financial statements are prepared in accordance with a special purpose framework, additional terms include:

- A description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP,
- A description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual basis of accounting, and
- Additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation

**Note:** If the accountant is not satisfied about any of the matters set out in AR-C 60 (paragraph .25) as preconditions for accepting a compilation engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

4. A compilation engagement does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements.

#### **Independence—compilation engagement and preparation of financial statements**

It is typical for an accountant who performs a compilation engagement to also prepare financial statements. The preparation of financial statements is a nonattest service while the compilation engagement is an attest engagement.

If an accountant performs a compilation engagement and also prepares financial statements, the accountant is performing a nonattest service (preparation) for an attest client. In such a case, the accountant's independence is impaired unless the accountant applies certain safeguards required by the *Nonattest Services* subtopic of the Independence Rule found in ET sec. 1.295 of the AICPA Professional Standards.

Those safeguards, which are discussed further on in the review engagement section of this course, include three requirements:

- (1) The accountant must not assume management responsibilities for the nonattest service performed (preparation of financial statements in this case)
- (2) The client must agree to assume management responsibilities for the nonattest service (prepared financial statements service), and
- (3) There must be language in the engagement letter that confirms that the client, not the accountant, assumes management responsibility for the nonattest service performed (e.g., preparation of financial statements).

## Engagement Letter—Compilation

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AR-C 80 provides the following guidance for an accountant to obtain agreement on the compilation engagement terms:

1. The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate.
2. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following:
  - a. The objectives of the engagement
  - b. The responsibilities of management
  - c. The responsibilities of the accountant
  - d. The limitations of the compilation engagement
  - e. Identification of the applicable financial reporting framework for the preparation of the financial statements
  - f. The expected form and content of the accountant’s compilation report, and a statement that there may be circumstances in which the report may differ from its expected form and content.
3. The engagement letter or other suitable form of written agreement should be signed by both:
  - a. The accountant or the accountant’s firm, and
  - b. Management or those charged with governance, as appropriate.

**Observation:** Currently, SSARS No. 19 requires that an engagement agreement be in writing but does not require that the agreement be signed by both parties. SSARS No. 21 now requires that all engagement letters involving SSARS engagements (preparation, compilation and review engagements) must be signed by both the accountant and management and/or those charged with governance.

The roles of management and those charged with governance in agreeing upon the terms of the compilation engagement for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity’s structure, the agreement may be with management, those charged with governance, or both. When the agreement on the terms of engagement is only with those charged with governance, in accordance with paragraph 25(c) of AR-C 60, the accountant is required to obtain management’s agreement that it acknowledges and understands its responsibilities. Thus, in general, management should sign the engagement letter even if the board of directors also signs it.

4. A contract is another suitable form of written communication. The understanding with management regarding the services to be performed for compilation engagements is required to be in a documented form, and, accordingly, a verbal understanding is insufficient.

**Illustration 1—An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance With U.S. GAAP and to Perform a Compilation Engagement With Respect to Those Financial Statements**

**Facts:**

- The accountant is hired to prepare, as a nonattest service, the financial statements, including related notes.
- The accountant is also hired to perform a compilation engagement on the same financial statements for the same period.
- U.S. GAAP is the applicable framework.
- The accountant expects that his or her independence will not be impaired by performing the preparation of financial statements nonattest service.

To the appropriate representative of management of ABC Company:

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and perform a compilation engagement with respect to those financial statements. We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (a)

**Our Responsibilities**

The objective of our engagement is to:

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to and will not verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America and to assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSs:

- a. The selection of the financial reporting framework to be applied in the preparation of financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- h. To include the compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295- Nonattest Services] (b)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Accountant's Compilation Report."*(c)

### **Our Report**

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.

### **Other relevant information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney’s fees, resulting from management’s knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant or accountant’s firm]

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
[Signed]  
[Name and title]

\_\_\_\_\_  
[Date]

- (a) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (b) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (compilation engagement), the accountant is required to include language in the engagement letter in accordance with AICPA Professional Standards, Nonattest Services, ET section 1.295, to remain independent.
- (c) The legend “*See Accountant’s Compilation Report*” or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management should agree to it within the engagement letter.



**Illustration 1A—An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance With U.S. GAAP and to Perform a Compilation Engagement With Respect to Those Same Financial Statements—Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP. Accountant’s Independence Is Not Impaired.**

**Facts:**

- The accountant is hired to prepare the financial statements (nonattest service).
- The accountant is also hired to perform a compilation engagement on the same financial statements.
- U.S. GAAP is the applicable framework.
- No statement of cash flows is presented and substantially all disclosures required by U.S. GAAP are omitted.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX and the related statements of income, and changes in stockholders’ equity for the year then ended, and perform a compilation engagement with respect to those financial statements. These financial statements will not include a statement of cash flows and related notes to the financial statements.(a)

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services.(b)

We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

**Our Responsibilities**

The objective of our engagement is to:

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA’s Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to and will not verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America and to assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the financial reporting framework to be applied in the preparation of financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- h. To include the compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295—Nonattest Services] (d)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Accountant's Compilation Report."*(c)

### **Our Report**

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.

### **Other relevant information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney’s fees, resulting from management’s knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant or accountant’s firm]*

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
*[Signed]*  
*[Name and title]*

\_\_\_\_\_  
*[Date]*

- (a) In most cases, the preparation of financial statements involves the omission of both a statement of cash flows and substantially all disclosures. In such a situation, an additional sentence may be added stating:  
*“These financial statements will not include a statement of cash flows and related notes to the financial statements.”*
- (b) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (c) The legend “*See Accountant’s Compilation Report*” or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management should agree to it within the engagement letter.
- (d) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (compilation engagement), the accountant is required to include language in the engagement letter in accordance with AICPA Professional Standards, *Nonattest Services*, ET section 1.295, to remain independent.

**Illustration 1B—An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance With U.S. GAAP and to Perform a Compilation Engagement With Respect to Those Same Financial Statements—Financial Statements Omit the Statement of Cash Flows and Substantially All Disclosures Required by U.S. GAAP.**

Accountant’s Independence Is Impaired.

**Facts:**

- The accountant is hired to prepare the financial statements (nonattest service).
- The accountant is also hired to perform a compilation engagement on the same financial statements.
- U.S. GAAP is the applicable framework.
- No statement of cash flows and substantially all disclosures required by U.S. GAAP are omitted.
- The accountant expects that his or her independence will be impaired as a result of the performance of several nonattest services.

To the appropriate representative of management of ABC Company:

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX and the related statements of income, and changes in stockholders’ equity for the year then ended, and perform a compilation engagement with respect to those financial statements. These financial statements will not include a statement of cash flows and related notes to the financial statements.(a)

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services.(b)

We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

**Our Responsibilities**

The objective of our engagement is to:

- a. prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA’s Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to and will not verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America and to assist you in the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the financial reporting framework to be applied in the preparation of financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America
- h. To include the compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached

[ET 1.295 Nonattest Services language—removed—Accountant is not independent] (d)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Accountant's Compilation Report."*(c)

### **Our Report**

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. We will disclose that we are not independent in our report.

### **Other relevant information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
[Signed]  
[Name and title]

\_\_\_\_\_  
[Date]

- (a) In most cases, the preparation of financial statements will omit both a statement of cash flows and substantially all disclosures. In such a situation, an additional sentence may be added stating:  
*"These financial statements will not include a statement of cash flows and related notes to the financial statements."*
- (b) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (c) The legend "*See Accountant's Compilation Report*" or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management should agree to it within the engagement letter.
- (d) Nonattest Services language (ET 1.295 of AICPA Professional Standards) is removed because the accountant is not independent.

**Illustration 2—A Engagement Letter for a Compilation Engagement With Respect to Financial Statements Prepared in Accordance With the Tax basis of Accounting**

**Facts:**

- The accountant is hired to prepare, as a nonattest service, the financial statements, including related notes.
- The accountant is also hired to perform a compilation engagement on the same financial statements.
- Tax basis is the applicable framework.
- The accountant expects that his or her independence will not be impaired.

To the appropriate representative of management of ABC Company:

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet—tax basis as of December 31, 20XX and the related statements of income and retained earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements, and perform a compilation engagement with respect to those financial statements. We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services.(a)

**Our Responsibilities**

The objective of our engagement is to:

- a. prepare financial statements in accordance with the tax basis of accounting based on information provided by you, and
- b. apply accounting and financial reporting expertise to assist you in the presentation of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the tax basis of accounting.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA’s Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to and will not verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, nor provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

### Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is the preparation of the financial statements in accordance with the tax basis of accounting and to assist you in the presentation of the financial statements in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of the financial reporting framework to be applied in the preparation of financial statements.
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of financial statements in accordance with the tax basis of accounting.
  - The inclusion of all informative disclosures that is appropriate for the tax basis of accounting. This includes:
    - A description of the tax basis of accounting, including a summary of significant accounting policies, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be quantified, and
    - Informative disclosures similar to those required by accounting principles generally accepted in the United States of America.<sup>4</sup>
- h. To include the compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements unless a different understanding is reached.

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295—Nonattest Services] (b)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Accountant's Compilation Report."*(c)

### Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.

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<sup>4</sup> Reference to responsibility for informative disclosures is not required if substantially all disclosures ordinarily included in tax basis financial statements are omitted.



**Other relevant information**

Our fees for these services . . . .

*[The accountant may include language, such as the following, regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney’s fees, resulting from management’s knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a compilation engagement with respect to those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant or accountant’s firm]*

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
*[Signed]*  
*[Name and title]*

\_\_\_\_\_  
*[Date]*

- (a) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (b) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (compilation engagement), the accountant is required to include language in the engagement letter in accordance with AICPA Professional Standards, Nonattest Services, ET section 1.295, to remain independent.
- (c) The legend “*See Accountant’s Compilation Report*” or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management should agree to it within the engagement letter.

**Preparation of financial statements in a compilation, review or audit engagement—nonattest services performed for an attest client**

The preparation of financial statements is a nonattest service. An accountant who performs a preparation of financial statement (nonattest) engagement in addition to performing a compilation, review or audit engagement must address the independence issues found in the Nonattest Services subtopic of the Independence Rule of the AICPA Professional Standards (ET sec. 1.295). Those rules address situations in which a nonattest service is performed on an attest client. Compilation, review and audit engagements are all considered attest engagements.

Otherwise, the preparation of financial statements for an attest client (e.g., compilation, review or audit engagement) taints the accountant's independence and the accountant or auditor cannot perform a compilation, review or audit engagement. The exception is that the accountant could perform a compilation engagement and disclose a lack of independence in his or her report.

If an accountant performs a nonattest service, such as a preparation of financial statements engagement, for his or her attest client, independence is impaired unless the accountant satisfies three requirements found in ET sec 1.295 of the AICPA Professional Standards:

ET sec 1.295 provides that three requirements must be satisfied in order for an accountant to perform nonattest services for an attest client:

**Requirement 1:** *The accountant should not assume management responsibilities for the nonattest service performed for the attest client.*

**Requirement 2:** *Client must agree to assume management responsibilities for the nonattest services performed.*

**Requirement 3:** *There must be a written establishment and documentation with client in the engagement letter.*

**Requirement 1: The accountant should not assume management responsibilities for the nonattest service performed**

The accountant should not assume management responsibilities for the nonattest service performed for an attest client by doing any of the following:

- Authorizing, executing or consummating transactions, otherwise exercising authority on behalf of a client or having the authority to do so
- Preparing source documents, in electronic or other form, evidencing the occurrence of a transaction
- Having custody of client assets
- Deciding which recommendations of the member or other third parties to implement or prioritize
- Reporting to those in charge of governance (typically the board of directors) on behalf of management
- Serving as a client's stock transfer or escrow agent, registrar, general counsel or its equivalent
- Setting policies or strategic direction for the client
- Directing or accepting responsibility for the actions of the client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards
- Accepting responsibility for the management of a client's project
- Accepting responsibility for the preparation and fair presentation of the client's financial statements in accordance with the applicable financial reporting framework
- Accepting responsibility for designing, implementing, or maintaining internal controls
- Performing ongoing evaluations of the client's internal control as part of its monitoring services

**Requirement 2: Client must agree to assume management responsibilities for the nonattest service performed**

Before performing nonattest services for an attest client, an accountant should determine that the client has agreed to:

- Assume all management responsibilities
- Oversee the service, by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience
- Evaluate the adequacy and results of the nonattest services performed, and
- Accept responsibility for the results of the nonattest services.

**Requirement 3: There must be a written establishment and documentation with the client in the engagement letter**

Before performing the nonattest services, the accountant should establish and document in writing his or her understanding with the client (such as the board of directors, audit committee, or management) regarding:

- Objectives of the nonattest engagement
- Nonattest services to be performed
- Client's acceptance of its responsibilities
- Member's responsibilities
- Any limitations of the engagement

**Following is sample language that can be used in the engagement letter:**

**Sample 1: Abbreviated version (used in the SSARS No. 21 sample engagement letters):**

*You are also responsible for all management decisions and responsibilities and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are also responsible for evaluating the adequacy and results of the services performed and accepting responsibility for such services.*

**Sample 2: Elaborate version that encompasses all nonattest services:**

*In addition to the performance of our compilation (review) engagement, we will perform certain nonattest services including: bookkeeping services, payroll tax return preparation, preparation of the Company's federal and state income tax returns, and preparation of financial statements.*

*We, in our sole professional judgment, reserve the right to refuse to do any procedure or take any action that could be construed as assuming management responsibilities, including determining general ledger account classifications of certain transactions and approving journal entries.*

*We will advise you, with regard to tax positions taken in the preparation of the tax returns, but you must take all management responsibility with regard to those matters.*

*You agree that in connection with our performance of any nonattest service, you will:*

- Assume all management responsibilities,*
- Oversee the nonattest service, by designating an individual, preferably within senior management, who possesses the skill, knowledge and experience,*
- Evaluate the adequacy and results of the services, and*
- Accept responsibility for the results of our services.*

**Observation:** The abbreviated language in Sample 1 is included in the illustrative engagement letters found in SSARS No. 21. Although the illustrative engagement letters are nonauthoritative, an accountant can assume that the abbreviated language in Sample 1 used in those illustrative letters is acceptable and satisfies the requirements of ET section 1.295 of the AICPA Professional Standards. The author offers more expansive language found in Sample 2 because it is written to reflect the specific authoritative language found in ET section 1.295. Either Sample 1 or 2 is acceptable.

## The Accountant’s Knowledge and Understanding of the Entity’s Financial Reporting Framework—Compilation Engagement

In performing a compilation engagement, AR-C 80 requires that an accountant should obtain an understanding of the applicable financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements.

**Note:** SSARS No. 21 states that although the accountant is required to obtain an understanding of: a) the applicable financial reporting framework intended to be used in the preparation of the financial statements, and b) the significant accounting policies adopted by management, such a requirement does not prevent the accountant from accepting a compilation engagement for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such an understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the framework or the industry.

## Compilation Procedures

In performing a compilation engagement, AR-C 80 requires an accountant to perform the following procedures:

1. The accountant should *read the financial statements* in light of the accountant’s understanding of the applicable financial reporting framework and the significant accounting policies adopted by management and consider whether such financial statements appear to be appropriate in form and free from obvious material misstatements.
2. If, during the compilation engagement, the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, provided by management are incomplete, inaccurate, or otherwise unsatisfactory, the accountant should bring that to the attention of management and request additional or corrected information.

**Note:** In a compilation engagement, an accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have performed such inquiries or procedures and the results of those inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information provided by management is incorrect, incomplete, or otherwise unsatisfactory.

3. The accountant should propose appropriate revisions to the financial statements in the following circumstances if the accountant becomes aware during the course of the engagement that:
  - a. the financial statements do not adequately refer to, or describe the applicable financial reporting framework either through:
    - the financial statement titles, or
    - the notes to the financial statements.

- b. revisions to the financial statements are required for the financial statements to be in accordance with the applicable financial reporting framework, or
- c. the financial statements are otherwise misleading.

**Note:** Financial statements may be misleading if the applicable financial reporting framework includes the premise that the financial statements are prepared on the going concern basis, and undisclosed uncertainties exist regarding the entity’s ability to continue as a going concern.

If the accountant becomes aware that uncertainties exist regarding the entity’s ability to continue as a going concern, the accountant may suggest additional disclosures concerning the entity’s ability to continue as a going concern, in order to avoid the financial statements being misleading.

Disclosure of items, such as an uncertainty, is not required in financial statements in which substantially all the disclosures required by the applicable financial reporting framework are omitted.

- 4. The accountant should withdraw from the compilation engagement and inform management of the reasons for withdrawing if:
  - a. the accountant is unable to complete the engagement because management has failed to provide records, documents, explanations, or other information, including significant judgments, as requested, or
  - b. management does not make appropriate revisions that are proposed by the accountant or does not disclose such departures in the financial statements, and the accountant determines to not disclose such departures in the accountant’s compilation report.

**Note:** If an accountant withdraws from the engagement, the responsibility to inform management of the reasons for withdrawing provides an opportunity to explain the accountant’s ethical obligations. When making a determination about whether and how to withdraw from an engagement, the accountant may wish to consult with legal counsel.

### The New Accountant’s Compilation Report

SSARS No. 21 makes significant changes to the compilation report as compared with the report found in existing AR 80 of SSARS No. 19.

The following table compares the key elements of the new report with the existing compilation report.

<b>Comparison of Existing Versus New Compilation Report</b>		
<b>Description of Element</b>	<b>Existing AR 80 Compilation Report</b>	<b>New AR-C 80 (SSARS 21) Compilation Report</b>
Paragraphs	Three paragraphs	One paragraph
Addressee [Salutation to management or board of directors]	Yes	No <sup>5</sup>

<sup>5</sup> Although a salutation is not required in the SSARS 21 compilation report, nothing precludes an accountant from adding a salutation.

<b>Comparison of Existing Versus New Compilation Report</b>		
<b>Description of Element</b>	<b>Existing AR 80 Compilation Report</b>	<b>New AR-C 80 (SSARS 21) Compilation Report</b>
Report title	Yes <i>“Accountant’s Compilation Report”</i> or <i>“Accountant’s Independent Compilation Report”</i>	No <sup>6</sup>
Identify the entity whose financial statements have been subjected to the compilation engagements	Yes	Yes
Include a statement that the accountant performed a compilation engagement	We have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended.	We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA.
Identify the financial statements that have been subjected to the compilation engagement	Yes	Yes Expanded to include “related notes to the financial statements”
The date or period covered by the financial statements	Yes	Yes
Statement that accountant did not audit or review the financial statements and does not express an opinion	We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.	We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.
Statement that management is responsible for the financial statements	Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.	Management is responsible for the accompanying financial statements of XYZ Company.

<sup>6</sup> Although a report title is not required in the SSARS 21 compilation report, nothing precludes an accountant from adding a report title.

<b>Comparison of Existing Versus New Compilation Report</b>		
<b>Description of Element</b>	<b>Existing AR 80 Compilation Report</b>	<b>New AR-C 80 (SSARS 21) Compilation Report</b>
Accountant’s responsibility	Our responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.	None
Objective (definition) of a compilation engagement	The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.	None
Signature of accountant	The manual or printed signature of the accounting firm or the accountant, as appropriate.	The signature of the accountant or the accountant’s firm, either a manual, printed, or digital format.
Accountant’s city and state where he or she practices	Not required	Include the city and state where the accountant practices.
Date on accountant’s report	The date of the compilation report (the date of completion of the compilation should be used as the date of the accountant’s report).	The date of the report, which should be the date that the accountant has completed the procedures required.
Paragraph headings	None	None
Modification for lack of independence	Yes  Reasons can be identified as long as all reasons for lack of independence are identified.	Yes  Reasons can be identified as long as all reasons for lack of independence are identified.

**General rules for the new compilation report**

SSARS No. 21 (AR-C 80) provides the following rules related to the compilation report:

1. The accountant’s compilation report should be in writing and should:
  - a. include a statement that management (owners) is (are) responsible for the financial statements
  - b. identify the financial statements that have been subjected to the compilation engagement

**Note:** If financial statements include disclosures, in the first paragraph of the report, the financial statements include the *“related notes to the financial statements.”*

- c. identify the entity whose financial statements have been subjected to the compilation engagement
- d. specify the date or period covered by the financial statements
- e. include a statement that the accountant performed the compilation engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA

- f. include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on the financial statements
- g. include the signature of the accountant or the accountant’s firm, either a manual, printed, or digital format
- h. include the city and state where the accountant practices

**Note:** The city and state where the accountant practices may be indicated on letterhead that contains the issuing office’s city and state.

- i. include the date of the report, which should be the date that the accountant has completed the procedures required by this section
2. An accountant may request that management include a reference on each page of the financial statements to the accountant’s compilation report, such as:
- “See Accountant’s Report”
  - “See Accountant’s Compilation Report”
  - “See Independent Accountant’s Compilation Report”

**Observation:** It is generally understood that there is a risk that an accountant’s report could become detached from the related financial statements. If that occurs, financial statements with no report and no reference as to the level of service, could be received and relied on by a client or third party. SSARS No. 1 and its replacement, SSARS No. 19, have required that the accountant include a legend on each page of the financial statements such as “See Accountant’s Compilation Report” or “See Independent Accountant’s Compilation Report.” Unlike existing SSARS No. 19, the new SSARS No. 21 (AR-C 80) no longer requires that the accountant include a legend on each page of the financial statements such as “See Accountant’s Compilation Report.” Instead, SSARS No. 21 states that the accountant “*may wish to request that management include the legend on each page of the financial statements*” related to the accountant’s report. SSARS No. 21 also makes a suggestion, but not a requirement, that a similar legend be placed on each page of supplementary information, as well.

Some commentators believe that the ARSC should have made the legend mandatory in SSARS No. 21, just like it has been required previously. One reason for not requiring the legend is the fact that the financial statements belong to management, not the accountant. Thus, management could choose not to include any legend. Second, current audit standards do not require a legend be placed on financial statements pages although many auditors do, in fact, include a legend such as “See Auditor’s Report.”

The author believes it is important that an accountant does, in fact, include a legend such as “See Accountant’s Compilation Report” or “See Independent Accountant’s Compilation Report” on each page of compiled financial statements (including supplementary information), even though such a legend is no longer required.

Because the financial statements are the responsibility of management, the engagement letter should clearly state that management shall place on each page of the financial statements a reference (legend) “See Accountant’s Compilation Report” or similar legend.

The author suggests that the engagement letter include language similar to the following:

*You are also responsible for including the following reference on each page of the financial statements including supplementary information: “See Accountant’s Compilation Report.”*

**Accountant’s Compilation Report on Financial Statements Prepared in Accordance With a Special purpose framework**

If a compilation report is issued on financial statements prepared under a special purpose framework (such as tax basis), SSARS No. 21 provides special reporting rules:



1. Unless the entity elects to omit substantially all disclosures, the accountant should modify the compilation report when that accountant becomes aware that the financial statements do not include:
  - a. a description of the special purpose framework
  - b. a summary of significant accounting policies
  - c. an adequate description about how the special purpose framework differs from GAAP. (The effects of these differences need not be quantified), and
  - d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

**Note:** If an entity elects to omit substantially all disclosures, the four disclosures noted above in 1(a) through 1(d) are not required.

2. If financial statements are prepared in accordance with a contractual basis of accounting, the accountant should modify the compilation report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based.
3. The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should:
  - make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements, and
  - describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information when the financial statements are prepared in accordance with a regulatory or contractual basis of accounting.

**Note:** When the financial statements are prepared in accordance with a regulatory or contractual basis of accounting, the accountant is required to describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information. This is necessary to avoid misunderstandings when the financial statements are used for purposes other than those for which they were intended. The note to the financial statements may also describe any significant interpretations of the contract on which the financial statements are based.

4. The accountant's compilation report on financial statements prepared in accordance with a special purpose framework should include a separate paragraph that:
  - indicates that the financial statements are prepared in accordance with the applicable special purpose framework
  - refers to the note to the financial statements that describes the framework, if applicable, and
  - states that the special purpose framework is a basis of accounting other than GAAP.

#### **Description of the special purpose framework and report titles**

SSARS No. 21 requires that financial statements prepared on a special purpose framework (such as tax basis) must provide a description of the special purpose framework unless the entity elects to omit substantially all disclosures.

The SSARS states that the description may be included either:

- in the financial statement titles
- in the notes to the financial statements, or
- otherwise on the face of the financial statements.

SSARS No. 21 clarifies that traditional GAAP titles, such as balance sheet, statement of financial position, statement of income, etc. may be used for special purpose framework financial statements, provided such titles are “appropriately modified.”

Examples of financial statement titles that are suitable for special purpose framework financial statements include, but are not limited to the following:

**Modified cash basis:**

- Income Statement—Modified Cash Basis
- Statement of Income—Modified Cash Basis\*\*
- Statement of Cash Receipts and Disbursements

**Tax basis of accounting:**

- Balance Sheet—Tax Basis
- Statement of Assets, Liabilities, and Equity—Tax Basis
- Statement of Operations—Tax Basis
- Statement of Revenue and Expenses—Tax Basis
- Statement of Income—Tax Basis\*\*

**Regulatory Basis:**

- Statement of Income—Regulatory Basis
- Balance Sheet—Regulatory Basis

\*\* *Added to list by author.*

**Observation:** For years there has been confusion as to the titles that could be used for non-GAAP financial statements such as income tax basis financial statements. The general rules were originally found in SAS No. 62, Special Reports, which stated that other comprehensive basis of accounting (OCBOA) financial statements should be “suitably titled” so as not to imply they are GAAP financial statements. SAS No. 62 provided limited guidance as to what was “suitably titled” and what was not.

Although not codified within SAS No. 62, some commentators, including the author, have believed that suitably titled financial statements could use the terms “balance sheet” and “statement of income” provided there was an appropriate suffix such as “income tax basis” or “cash basis” etc. Thus, the titles “balance sheet—income tax basis” and “statement of income—income tax basis” were appropriate titles if reporting on income tax basis financial statements under the pre-SSARS No. 21 rules. Yet, some peer reviewers and other parties took a far more narrow position that the terms “balance sheet” and “statement of income” could not be used in an OCBOA title regardless of whether an “income tax basis” suffix was attached. Thus, many practitioners have used titles such as “statement of assets, liabilities and equity—income tax basis” and “statement of revenues and expenses—income tax basis” even though titles such as “balance sheet—income tax basis” and “statement of income—income tax basis” could have been used.

SSARS No. 21 finally brings clarity to the situation by stating that with respect to special purpose frameworks, (such as tax basis), GAAP titles may be used provided such titles are “appropriately modified.” SSARS No. 21 does offer some examples of titles that are considered “appropriately modified.”

Following are examples of “appropriate” special purpose framework titles:

- Balance Sheet—Tax Basis\*\*
- Statement of Income—Tax Basis\*\*
- Statement of Income—Regulatory Basis
- Balance Sheet—Regulatory Basis

\*\* *Title included by author but not included in list found in SSARS No. 21.*

### **Special purpose framework disclosures**

If special purpose framework financial statements are issued, those financial statements must include four disclosures related to the special purpose framework as follows:

1. a description of the special purpose framework
2. a summary of significant accounting policies
3. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified, and
4. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

If, however, management elects to omit substantially all disclosures, and such an omission is not undertaken with the intention to mislead potential users of such financial statements, the above presented four disclosures are not required.

### **Description of how the special purpose framework differs from GAAP**

SSARS No. 21 states that the description of how the special purpose framework differs from GAAP ordinarily only includes the material differences between GAAP and the special purpose framework. For example, if several items are accounted for differently in accordance with the special purpose framework than they would be in accordance with GAAP, but only the differences in how depreciation is calculated are material, a brief description of the depreciation differences is all that would be necessary, and the remaining differences need not be described or quantified.

### **Informative disclosures similar to those required by GAAP**

Financial statements prepared when applying a special purpose framework are not considered appropriate in form unless the financial statements include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

### **Reporting When the Accountant Is Not Independent**

When the accountant is not independent with respect to an entity for which a compilation engagement is performed, the accountant should do the following:

1. Indicate the accountant's lack of independence in a final paragraph of the accountant's compilation report.
2. If the accountant elects to disclose a description about the reasons the accountant's independence is impaired, the accountant should include all such reasons in the description. An example of a disclosure that an accountant may make to indicate the accountant's lack of independence would be:

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

3. The accountant is not precluded from disclosing a description about the reason(s) that the accountant's independence is impaired. The following are examples of descriptions the accountant may use:

*I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.*

*I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.*

*I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.*

### **Reporting on Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework**

SSARS No. 21 carries over from SSARS No. 19, rules that apply when compiled financial statements omit substantially all disclosures required by GAAP or the applicable financial reporting framework.

1. The accountant should not issue an accountant's compilation report on financial statements that omit substantially all disclosures required by the applicable financial reporting framework unless the omission of substantially all disclosures is not, to the accountant's knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements.
2. When reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements:
  - a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with a special purpose framework)
  - b. A statement that if the omitted disclosures (and the statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the entity's financial position, results of operations, and cash flows (or the equivalent for presentations other than GAAP)
  - c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters:

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

3. When management elects to include disclosures about only a few matters in the notes to the financial statements, such disclosures may be labeled:

*"Selected Information—Substantially All Disclosures Required by Accounting Principles Generally Accepted in the United States of America Are Not Included."*
4. The omission of one or more notes, when substantially all other disclosures are presented, should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed.

### **Reporting Known Departures From the Applicable Financial Reporting Framework**

SSARS No. 21, in general, carries over the guidance found in SSARS No. 19 with respect to reporting on known GAAP (or other framework) departures in the compilation engagement:

1. When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements and the financial

statements are not revised, or the departure is not disclosed in the notes to the financial statements, the accountant should modify the compilation report to disclose the departure.

2. The effects of the departure on the financial statements should be disclosed if such effects have been determined by management or are readily known to the accountant as the result of the accountant's procedures.
3. If the effects of the departure have not been determined by management or are not readily known to the accountant as a result of the accountant's procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances, the accountant should state in the report that such determination has not been made by management.
4. If the accountant believes that modification of the compilation report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the engagement and provide no further services with respect to those financial statements.
5. The accountant should not modify the compilation report to include a statement that the financial statements are not in conformity with the applicable financial reporting framework.

**Notes:** SSARS No. 21 states that an accountant is precluded from including a statement that the financial statements are not in conformity with the applicable financial reporting framework because such a statement would be tantamount to expressing an adverse opinion on the financial statements as a whole. Such an opinion can be expressed only in the context of an audit engagement.

### **Reporting on Supplementary Information**

#### **Supplementary Information That Accompanies Financial Statements and the Accountant's Compilation Report**

SSARS No. 21 expands some of the language found in SSARS No. 19 with respect to supplementary information that accompanies a compilation report.

1. Although not required to perform a compilation engagement on supplementary information that accompany financial statements and the accountant's compilation report, nothing precludes the accountant from performing a compilation engagement on the supplementary information if engaged to do so.
2. If an accountant issues a compilation report on the financial statements, the accountant may report on any supplementary information as follows:
  - Option 1: Compile the supplementary information, or
  - Option 2: Disclaim the supplementary information

An accountant who compiles the financial statements is not permitted to review the supplementary information. The accountant is also not permitted to audit the supplementary information in compiled financial statements.

3. When supplementary information accompanies compiled financial statements and the accountant's compilation report, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either:
  - a. An other-matter paragraph in the accountant's compilation report on the financial statements, or
  - b. A separate report on the supplementary information.

**Option 1—Compile the Supplementary Information:** When the accountant has performed a compilation engagement with respect to both the financial statements and the supplementary information, the accountant should either:

- a. Include an other-matter paragraph in the accountant’s compilation report on the financial statements, or
- b. Issue a separate report on the supplementary information,

Either an other-matter paragraph or a separate report should state the following:

- the information is presented for purposes of additional analysis and is not a required part of the financial statements
- the information is the representation of management
- the accountant performed a compilation engagement in accordance with SSARSs promulgated by the AICPA on information that is the representation of management, and
- the accountant has not audited or reviewed the information and, accordingly, does not express an opinion, a conclusion, or provide any form of assurance on such information.

The following is an example of a separate paragraph in the accountant’s compilation report addressing supplementary information when the accountant has performed a compilation engagement on both the financial statements and the supplementary information:

The schedule of operating expenses [*or other identified supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have performed a compilation engagement on the information. I (We) have not audited or reviewed the information and, accordingly, do not express an opinion, a conclusion, or provide any assurance on such information.

**Option 2—Disclaim the Supplementary Information:** When the accountant has performed a compilation engagement with respect to the financial statements but has not performed a compilation engagement with respect to the supplementary information (disclaimed the supplementary information), the accountant should either:

- a. Include an other-matter paragraph in the accountant’s compilation report on the financial statements, or
- b. Issue a separate report on the supplementary information

Either an other-matter paragraph or separate report should state the following:

- the information is presented for purposes of additional analysis and is not a required part of the financial statements
- the information is the representation of management
- the accountant has not audited, reviewed, or performed a compilation engagement with respect to the information and, accordingly, does not express an opinion, a conclusion, or provide any form of assurance on such information.

The following is an example of how an accountant may word a separate paragraph in the accountant’s compilation report addressing supplementary information when the accountant has performed a compilation engagement on the financial statements but has not performed a compilation on the supplementary information:

The schedule of operating expenses [*or other identified supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. We have not audited, reviewed, or performed a compilation engagement on the information and, accordingly, I (we) do not express an opinion, a conclusion, or provide any assurance on it.

4. The accountant may request that management include a reference to the accountant’s compilation report on each page of the supplementary information.

An example of a reference to the accountant’s compilation report included on each page of the supplementary information is:

“*See Accountant’s Report*”

“*See Accountant’s Compilation Report*”

“*See Independent Accountant’s Compilation Report*”

**Observation:** SSARS No. 21 makes a significant change to existing SSARS No. 19 by eliminating the requirement that each page of compiled financial statements include a reference (legend) such as “*See Accountant’s Compilation Report*.” Although the inclusion of a legend on each page is no longer required, the author recommends that an accountant include a legend on each page. Interestingly, now that there is no required compilation report title, if a legend such as “*See Accountant’s Compilation Report*” is included on each page of the compiled financial statements, query how the user knows where the “*compilation report*” is located if there is no longer a report title to identify a compilation report?

#### Required Supplementary Information

1. With respect to required supplementary information, the accountant should include an other-matter paragraph in the accountant’s compilation report on the financial statements. The other-matter paragraph should include language to explain the following circumstances, as applicable:
  - a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
  - b. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
  - c. The required supplementary information is omitted.
  - d. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines.

**Note:** Prescribed guidelines are the authoritative guidelines established by the designated accounting standard-setter for the methods of measurement and presentation of the required supplementary information.

- e. The accountant has identified departures from the prescribed guidelines.
  - f. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.
2. Examples of required supplementary information that may accompany financial statements and the accountant’s compilation report thereon include the following:
  - With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB ASC 972-235-50-3, *Real Estate—Common Interest Realty Associations*.
  - Management’s discussion and analysis and budgetary comparison statements as required by Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*.
3. If the entity has presented all or some of the required supplementary information and the accountant did not perform a compilation engagement on the required supplementary information, the separate paragraph in the accountant’s compilation report should include the following elements:
  - a. A statement that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] requires that the [*identify the required supplementary information*] be presented to supplement the basic financial statements

- b. A statement that such information, although not part of the basic financial statements, is required by *[identify designated accounting standard-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- c. A statement that the accountant did not perform a compilation, review, or audit on the required supplementary information and, accordingly, does not express an opinion, a conclusion, or provide any assurance on the information
- d. If some of the required supplementary information is omitted:
  - a statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* required to be presented to supplement the basic financial statements
  - a statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standard-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist *[describe the material departures from the applicable financial reporting framework]*, and
- f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by *[identify designated accounting standard-setter]*.

**Note:** Because the required supplementary information accompanies the basic financial statements, the accountant’s compilation report on the financial statements includes a discussion of the responsibility taken by the accountant on that information. However, if the required supplementary information is omitted by the entity, the accountant does not have a responsibility to present that information.

4. If all the required supplementary information is omitted, the separate paragraph in the accountant’s compilation report should include the following elements:
  - a. A statement that management has omitted *[description of the missing required supplementary information]* that *[identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)]* required to be presented to supplement the basic financial statements
  - b. A statement that such missing information, although not a part of the basic financial statements, is required by *[identify designated accounting standard-setter]*, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context

### **Elimination of Management Use Only Financial Statements**

SSARS No. 21 eliminates the option of issuing management use only financial statements found in SSARS No. 19 which was originally found in SSARS No. 8.

The management use only financial statement rules permit an accountant to issue compiled financial statements without a compilation report, provided the financial statements are not expected to be issued to a third party (e.g., the financial statements are issued for management use only).

Under the current SSARS No. 19, AR 80 compilation rules, an accountant is permitted to issue management use only financial statements as follows:

- An engagement letter is executed in which management agrees to restrict the use of the financial statements to management’s use.



- Compiled financial statements are issued without a compilation report.
- All of the existing compilation standards found in AR 80 of SSARS No. 19 apply.
- Each page of the financial statements must have a legend restricting their use, such as:  
*Restricted for Management’s Use Only, or*  
*Solely for the Information and Use by the Management of XYZ Corporation and not intended to be and should not be used by any other party*

**Observation:** Management use only financial statements are essentially a compilation engagement without a compilation report being issued. All of the performance requirements for a compilation engagement under SSARS No. 19 must be adhered to except that no compilation report is issued.

### **What is the impact of eliminating management use only financial statements in SSARS No. 21?**

With SSARS No. 21’s elimination of the management use only financial statement option, now, in all instances, a compilation report must be issued in a compilation engagement.

Practitioners and their clients no longer have the option to perform a compilation engagement and issue financial statements for management use only without a report.

So, what do those practitioners use in place of the management use only engagement option?

One choice is for the practitioner to issue prepared financial statements under AR-C 70, which was discussed in the previous section of this course. In issuing prepared financial statements, those statements are issued without a report except that there is no restriction for use. That is, the prepared financial statements may be issued to third parties.

### **Examples of the Accountant’s Compilation Reports on Financial Statements**

Following are sample compilation reports extracted from SSARS No. 21, as modified by the author.

#### **Illustration 1—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP**

**Facts:**

- Standard compilation report for comparative years
- U.S. GAAP
- Full set of financial statements that includes a statement of cash flows and notes to financial statements

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income and retained earnings, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

**Observation:** Notice that the new compilation report has no title, and no salutation (addressee). Moreover, the report fails to include a description of a compilation engagement. Lastly, because there are disclosures, the first paragraph includes: “the related notes to the financial statements.” Further, the new compilation report requires that the accountant’s city and state be included on the report or at least on the report page.

**Illustration 1A—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP.**

Management Has Elected to Omit Substantially All Disclosures and the Statement of Cash Flows.

**Facts:**

- Standard compilation report for comparative years
- U.S. GAAP
- Management has elected to omit the statement of cash flows and substantially all disclosures required by U.S. GAAP

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income and retained earnings for the years then ended in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

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

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

**Observation:** Because management has elected to omit substantially all disclosures, the first paragraph no longer includes “related notes to financial statements” in the description of the financial statements covered by the report. Moreover, the statement of cash flows is not described in the first paragraph because it has been omitted.

Chapter 4 – AR-C Section 80

XYZ Company		
Balance Sheets		
December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

XYZ Company Statements of Income and Retained Earnings Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

**Note:** SSARS No. 21 no longer requires that a legend be included on each page such as, “*See Accountant’s Report,*” “*See Accountant’s Compilation Report*” or “*See Independent Accountant’s Compilation Report.*” Therefore, both the balance sheet and statement of income do not include any such legend.

**Illustration 1B—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP. Management Has Elected to Omit Substantially All Disclosures and the Statement of Cash Flows. A Schedule of Operating Expenses is Presented as Supplementary Information.**

**Facts:**

- Standard compilation report for comparative years using U.S. GAAP
- Management has elected to omit the statement of cash flows and substantially all disclosures required by U.S. GAAP
- Supplementary information in the form of a schedule of operating expenses is included with the financial statements

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income and retained earnings for the years then ended in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

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

*[Compile supplementary information] (1)*

The schedule of operating expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have performed a compilation engagement on the information. I (We) have not audited or reviewed the information and, accordingly, do not express an opinion, a conclusion, or provide any assurance on such information, or

*[Disclaim supplementary information] (1)*

The schedule of operating expenses is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have not audited, reviewed, or performed a compilation engagement on the information and, accordingly, I (we) do not express an opinion, a conclusion, or provide any assurance on it.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

(1) Paragraph heading is shown for illustrative purposes and should not be shown with the actual report that is issued.

Chapter 4 – AR-C Section 80

XYZ Company Balance Sheets December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

XYZ Company Statements of Income and Retained Earnings Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

XYZ Company Schedules of Operating Expenses Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Rent	\$XX	\$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

**Note:** SSARS No. 21 no longer requires that a legend be included on each page such as, “See Accountant’s Report,” “See Accountant’s Compilation Report” or “See Independent Accountant’s Compilation Report.” Therefore, both the balance sheet and statement of income, as well as the schedule of operating expenses do not include any such legend.

**Illustration 2—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities**

- Standard compilation report for comparative years
- AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs)

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the statements of financial position of XYZ Company, as of December 31, 20X6 and 20X5, and the related statements of operations and cash flows for the years then ended, and the related notes to the financial statements in accordance with the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities, and for determining that the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities is an acceptable financial reporting framework. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the AICPA’s Financial Reporting Framework for Small- and Medium-Sized Entities, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*



**Illustration 3—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With the Tax Basis of Accounting. Management Has Elected to Omit Substantially All Disclosures Ordinarily Included in Financial Statements Prepared in Accordance With the Tax Basis of Accounting**

- Standard compilation report for comparative years
- Tax basis financial statements
- Management elects to omit substantially all disclosures ordinarily included in tax basis financial statements
- No statement of cash flows is presented

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheet—tax basis as of the years ended December 31, 20X6 and 20X5, and the related statements of income and retained earnings—tax basis, for the years then ended in accordance with the tax basis of accounting, and for determining that the tax basis of accounting is an acceptable financial reporting framework.<sup>7</sup> I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (We) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

The financial statements are prepared in accordance with the tax basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

Management has elected to omit substantially all the disclosures ordinarily included<sup>8</sup> in financial statements prepared in accordance with the tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user’s conclusions about the company’s assets, liabilities, equity, revenue, and expenses. Accordingly, the financial statements are not designed for those who are not informed about such matters.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

<sup>7</sup> AR-C 80 states that when special purpose framework financial statements are prepared and management has a choice of frameworks, the accountant’s compilation report should reference management’s responsibility for determining that the framework is acceptable.

<sup>8</sup> The term “ordinarily included” is used when tax basis financial statements are issued in lieu of the term “required” for GAAP statements.

XYZ Company		
Balance Sheets— <b>Tax Basis</b>		
December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
<u>ASSETS</u>		
Cash	\$XX	\$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>
 <u>LIABILITIES AND STOCKHOLDERS' EQUITY</u>		
<u>Liabilities:</u>		
Accounts payable	\$XX	\$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
<u>Stockholders' equity:</u>		
Common stock	XX	XX
Retained earnings	<u>XX</u>	<u>XX</u>
	<u>XX</u>	<u>XX</u>
	<u>\$XX</u>	<u>\$XX</u>

XYZ Company		
Statements of Income and Retained Earnings— <b>Tax Basis</b>		
Years Ended December 31, 20X6 and 20X5		
	<u>20X6</u>	<u>20X5</u>
Net sales	\$XX	\$XX
Cost of goods sold	<u>XX</u>	<u>XX</u>
Gross profit	XX	XX
Operating expenses	<u>XX</u>	<u>XX</u>
Net operating income	XX	XX
Other income	<u>XX</u>	<u>XX</u>
Net income before income taxes	XX	XX
Income taxes	<u>XX</u>	<u>XX</u>
Net income	XX	XX
Retained earnings:		
Beginning of year	<u>XX</u>	<u>XX</u>
End of year	<u>\$XX</u>	<u>\$XX</u>

**Note:** SSARS No. 21 no longer requires that a legend be included on each page such as, “*See Accountant’s Report,*” “*See Accountant’s Compilation Report*” or “*See Independent Accountant’s Compilation Report.*” Therefore, both the balance sheet and statement of income do not include any such legend.

**Illustration 4—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP When the Accountant’s Independence Has Been Impaired, and the Accountant Determines to Not Disclose the Reasons for the Independence Impairment**

- Standard compilation report for comparative years
- Accountant is not independent

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income, changes in stockholder’s equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

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

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

**Illustration 5—An Accountant’s Compilation Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP When the Accountant’s Independence Has Been Impaired, and the Accountant Decides to Disclose the Reason for the Independence Impairment**

- Standard compilation report for comparative years under U.S. GAAP
- Accountant is not independent and wishes to disclose the reason for the lack of independence

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income, changes in stockholder’s equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

I am (we are) not independent with respect to XYZ Company as during the year ended December 31, 20X6, I had a direct financial interest in XYZ Company.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s report]*

**Illustration 6—An Accountant’s Compilation Report on Comparative Financial Statements, and the Accountant Is Aware of a Departure From U.S. GAAP**

- Standard compilation report for comparative years
- U.S. GAAP
- GAAP departure

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income, changes in stockholder’s equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

Accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) that XYZ Company has stated its land at appraised value and that if accounting principles generally accepted in the United States of America had been followed, the land account and stockholders’ equity would have been decreased by \$500,000.

*[Signature of accounting firm or accountant, as appropriate]*  
*[Accountant’s city and state]*  
*[Date of the accountant’s report]*

**Is an accountant permitted to modify the standard compilation report to include a salutation (addressee) and a report title?**

Although there are both compliments and criticisms of the new compilation report, those practitioners who do not like the new report generally identify the following reasons for their displeasure:

- The report does not define what a compilation engagement is.
- There is no salutation (addressee) to the board of directors, members and/or management.
- There is no report title.

The question is whether a practitioner could choose to add a salutation and a report title even though they are not part of the standard compilation report.

The answer is that there is nothing in SSARS No. 21 that precludes an accountant from adding a salutation (addressee) and/or a report title, although not required.

If added, the report would look like the following sample report:

Accountant's Compilation Report (1)

To the Board of Directors and Management (1)  
XYZ Company

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5 and the related statements of income, changes in stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant's city and state]*

*[Date of the accountant's report]*

(1) The new compilation report does not require a report title or a salutation (addressee). The above sample report offers these elements as an option because SSARS No. 21 does not preclude their inclusion.

### **Documentation in a Compilation Engagement**

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AR-C 80 states that an accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

- An engagement letter or other suitable form of written documentation, signed by both the accountant and management
- A copy of the financial statements, and
- A copy of the accountant's report.

## Review Questions

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1. In accordance with AR-C 80, when is an accountant required to perform a compilation engagement?
  - A. When he or she has submitted financial statements
  - B. When he or she is hired to perform a compilation engagement
  - C. When he or she is unable to perform a review engagement
  - D. When he or she prepares financial statements under AR-C 70
  
2. Jimmy Smith is a CPA who is performing a compilation engagement on a client. For that client, Jimmy also prepares financial statements, which is a nonattest service. Which of the following is correct?
  - A. Jimmy must take responsibility for the financial statements Jimmy prepared
  - B. The client is precluded from taking responsibility for the prepared financial statements
  - C. Jimmy must not take responsibility for the financial statements
  - D. The third party user must take responsibility for the financial statements to be received
  
3. Which of the following would be considered an action in which an accountant assumes management responsibilities for an attest client?
  - A. Authorizing a transaction
  - B. Proposing journal entries to be approved by management
  - C. Performing analytical procedures
  - D. Conducting inquiries
  
4. Alysia is an accountant who is performing a compilation engagement on a new client in the distribution industry. Alysia has no experience in this industry. Which of the following is correct?
  - A. SSARS No. 21 precludes Alysia from performing a compilation engagement in an industry in which she has no previous experience
  - B. Alysia is not prevented from accepting the engagement for an entity in which she has no previous experience
  - C. Alysia may accept the engagement only after obtaining continuing professional education (CPE) related to the industry
  - D. SSARS No. 21 is silent on this issue
  
5. An accountant is unable to complete his compilation engagement because management has failed to provide records and documents, as requested. What should the accountant do?
  - A. The accountant should withdraw from the engagement and explain the reasons why
  - B. The accountant should report the client to the third party users
  - C. The accountant should go around the client and obtain the information directly from third parties
  - D. The accountant should do nothing and complete the engagement without the missing records and documents because it is only a compilation engagement
  
6. Monti Hall is preparing a compilation report for a client under the new AR-C 80 compilation standards. Which of the following is correct with respect to the new compilation report?
  - A. An addressee is required
  - B. A report title is not required
  - C. The entity is no longer identified in the report
  - D. The date and period covered is no longer required

7. Under the new AR-C 80 standards, in a compilation engagement, a legend “*See Accountant’s Compilation Report*” is \_\_\_\_\_.
- A. Required
  - B. Not required
  - C. Not permitted
  - D. Changed to “*See Accountant’s Report*”
8. Lucy Lewy is issuing a compilation report on tax basis financial statements, a special purpose framework. Which of the following is a situation in which Lucy should not modify her compilation report?
- A. The financial statements do not include a description of the special purpose framework
  - B. A summary of significant accounting policies is omitted
  - C. The financial statements omit an adequate description about how the tax basis differs from GAAP
  - D. There is no quantified analysis of the differences between tax basis and GAAP
9. If an accountant is preparing a compilation report on financial statements prepared using a special purpose framework, the accountant should describe the purpose for which the financial statements are prepared when the financial statements are prepared in accordance with \_\_\_\_\_.
- A. A regulatory basis
  - B. The tax basis
  - C. A cash basis
  - D. GAAP
10. Which of the following is not an appropriate title for a special purpose framework financial statement?
- A. Balance Sheet—Tax Basis
  - B. Statement of income—Regulatory Basis
  - C. Statement of Income
  - D. Statement of Cash Receipts and Disbursements
11. Eliah Levin is an accountant who is asked to perform a compilation engagement for his wife’s business. How should Eliah address the independence issue in his report?
- A. Eliah has no independence issue because of the special exemption for husband and wife businesses
  - B. Eliah must disclose the lack of independence in the report
  - C. Eliah must disclose the lack of independence in the notes
  - D. Eliah must include a legend on each page of the financial statements stating “*Accountant is Not Independent*”
12. Jennifer Lopez is issuing a compilation report on financial statements. A schedule of operating expenses is accompanying the financial statements. What are Jennifer’s reporting options with respect to the schedule of operating expenses?
- A. Jennifer may review the schedule as supplementary information
  - B. Jennifer may audit the schedule as supplementary information
  - C. Jennifer may compile the schedule as supplementary information
  - D. Jennifer may treat the schedule as if it were a separate financial statement such as a balance sheet or income statement and report on it as a financial statement and not as supplementary information



13. Which option under SSARS No. 21 does the author suggest offers the best alternative to issuing management use only financial statements under SSARS No. 19?
  - A. Perform a compilation engagement and issue a traditional compilation report
  - B. Perform a preparation of financial statements engagement under AR-C 70
  - C. Upgrade to a review engagement
  - D. There is no viable alternative
  
14. Which of the following is a required item that must be documented in a compilation engagement under AR-C 80?
  - A. An engagement letter
  - B. A schedule of analytical procedures performed
  - C. A list of inquiries performed during the engagement
  - D. A management representation letter
  
15. Elaine is a CPA who is performing a compilation engagement on a common interest realty association. There is required supplementary information that must accompany the financial statements. How should Elaine report on this required supplementary information?
  - A. Disclose it only with no modification to the compilation report
  - B. Include an emphasis-of-matter paragraph in the compilation report
  - C. Include an other-matter paragraph in the compilation report
  - D. Do nothing because there is no required supplementary information disclosure or reporting rules found in SSARS No. 21

## Review Answers

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1.
  - A. Incorrect. The existing rules found in AR 80 have as a threshold that an accountant must compile financial statements if he or she has submitted financial statements. This requirement is eliminated by AR-C 80.
  - B. **Correct.** Under AR-C 80, the only time in which an accountant is be required to perform a compilation engagement is when he or she is hired to perform a compilation engagement. The accountant is never forced to perform a compilation engagement.
  - C. Incorrect. AR-C 80 does not provide any guidance for dropping down to a compilation engagement if the accountant is unable to perform a review engagement.
  - D. Incorrect. A preparation engagement under AR-C 70 is separate and distinct from a compilation engagement under AR-C 80.
  
2.
  - A. Incorrect. In order for Jimmy to maintain his independence when performing a nonattest service for an attest client, Jimmy must not take responsibility for the financial statements that Jimmy prepared. That responsibility rests with the client, not Jimmy. Thus, the answer is correct.
  - B. Incorrect. The client must take responsibility for the nonattest service performed (preparation of financial statements) making the answer incorrect.
  - C. **Correct.** Jimmy must not take responsibility for the financial statements in order to maintain his independence with respect to the attest client. This rule applies because Jimmy is performing a nonattest service (preparation of financial statements) for an attest client (compilation engagement performed).
  - D. Incorrect. The third party user has no responsibility for the financial statements to be received. That responsibility rests with the client.
  
3.
  - A. **Correct.** If an accountant authorizes a transaction, that action is considered assuming management responsibilities.
  - B. Incorrect. Simply proposing journal entries is not considered assuming management responsibilities as those entries are to be approved by management.
  - C. Incorrect. An accountant performing analytical procedures is not an action in which an accountant is assuming management responsibilities. The performance of analytical procedures is an action that is part of the accountant's engagement and does not result in the accountant assuming management responsibilities by authorizing, executing, or consummating transactions on behalf of the client.
  - D. Incorrect. Conducting inquiries by an accountant is not an action that results in the accountant assuming management responsibilities because the accountant is not authorizing, executing or consummating transactions on behalf of the client.
  
4.
  - A. Incorrect. SSARS No. 21 does not preclude Alysia from performing a compilation engagement in an industry in which she has no previous experience, making the answer incorrect.
  - B. **Correct.** AR-C 80 states that the accountant is not prevented from accepting a compilation engagement for an entity in an industry in which the accountant has not previous experience. The accountant must, however, still obtain an understanding of the framework and accounting policies used in the preparation of the financial statements.
  - C. Incorrect. There is no CPE requirement in AR-C 80 or SSARS No. 21, taken as a whole. However, an accountant may wish to consult with professional literature such as AICPA guides, industry publications, and other publications.
  - D. Incorrect. SSARS No. 21 does address this issue making the answer incorrect.
  
5.
  - A. **Correct.** AR-C 80 states that the accountant should withdraw from the engagement and explain the reasons why if he or she is unable to complete the engagement because management has failed to provide records, documents, explanations, or other information.

- B. Incorrect. There is no authority to report the client to the third party users
  - C. Incorrect. The accountant has no authority to go around the client and obtain the information directly from third parties. Such an action would require the client's approval.
  - D. Incorrect. AR-C 80 states that the accountant must do something which is to withdraw from the engagement. Thus the answer is incorrect.
- 6.
- A. Incorrect. The new report does not require that an addressee be included.
  - B. **Correct.** AR-C 80's compilation report no longer requires a report title, such as "*Accountant's Compilation Report*" making the answer correct.
  - C. Incorrect. AR-C 80 maintains the requirement that the entity is identified in the report, making the answer incorrect.
  - D. Incorrect. The AR-C 80 report carries over the requirement that the date and period covered is still required.
- 7.
- A. Incorrect. AR-C 80 no longer requires that the legend be included on each page of the financial statements, making the answer incorrect.
  - B. **Correct.** AR-C 80 states that an accountant "may request" that management include the reference on each page of the financial statements, which means it is not required.
  - C. Incorrect. Nothing found in AR-C 80 states that it is not permitted, making the answer incorrect.
  - D. Incorrect. AR-C 80 does not changed "*See Accountant's Compilation Report*" to "*See Accountant's Report,*" making the answer incorrect.
- 8.
- A. Incorrect. If the financial statements do not include a description of the special purpose framework, AR-C 80 requires that the report be modified making the answer incorrect.
  - B. Incorrect. AR-C 80 states that Lucy must modify her report if the financial statements omit the summary of significant accounting policies. Such an omission is a departure. Thus the answer is incorrect.
  - C. Incorrect. AR-C 80 states that if the financial statements omit an adequate description about how the tax basis differs from GAAP, Lucy must modify her report, making the answer incorrect.
  - D. **Correct.** AR-C 80 does require that a disclosure have an adequate description about how the tax basis differs from GAAP. However, it does not require that the differences be quantified. Thus, the answer is correct in that it is a situation in which Lucy should not modify her compilation report.
- 9.
- A. **Correct.** The accountant must describe the purpose or refer to a note that contains that information if the regulatory basis is used. It also applies if the contractual-basis of accounting is used. The reason is to avoid any misunderstandings in the use of the financial statements.
  - B. Incorrect. AR-C 80 does not impose any requirement to describe the purpose if the tax basis is used, making the answer incorrect.
  - C. Incorrect. There is no requirement to describe the purpose if the cash basis is used. Thus, the answer is incorrect.
  - D. Incorrect. GAAP is not a special purpose framework so that any rules related to a special purpose framework would not apply.
- 10.
- A. Incorrect. The title is appropriate. Although the term "balance sheet" (a GAAP title) is in the title, the suffix "tax basis" notifies the user that it is not a GAAP statement. SSARS No. 21 provides that traditional titles such as balance sheet may be used provided such titles are appropriately modified. Adding the suffix "tax basis" sufficiently modifies the title.
  - B. Incorrect. Adding the suffix "regulatory basis" to a GAAP title "statement of income" appropriately modifies the title to be in compliance with SSARS No. 21 requirements.

- C. **Correct.** Use of a GAAP title, “statement of income” is not an appropriate title for a special purpose framework if it is not modified with a suffix such as “tax basis.”
- D. Incorrect. The title “statement of cash receipts and disbursements” is an appropriate title for a special purpose framework as it clearly identifies that it is not a GAAP title.
11. A. Incorrect. Eliah and his wife are clearly related parties for which Eliah has an independence issue. There is no special exemption for a husband and wife.
- B. **Correct.** SSARS No. 21, AR-C 80 requires that Eliah disclose the lack of independence in the compilation report in the final paragraph.
- C. Incorrect. The lack of independence issue is a reporting matter that belongs in Eliah’s compilation report, not in the notes to financial statements, making the answer incorrect.
- D. Incorrect. The SSARSs do not have any requirement for Eliah to include a legend on each page of the financial statements stating “*Accountant is Not Independent.*” However, there is nothing that precludes the accountant to do so, either.
12. A. Incorrect. AR-C 80 states that an accountant who compiles financial statements is not permitted to review the supplementary information. Thus, the answer is incorrect.
- B. Incorrect. If the financial statements are compiled, the supplementary information may not be audited or reviewed because to do so would mean the level of service performed on the supplementary information would be higher than the level provided on the underlying financial statements.
- C. **Correct.** AR-C 80 permits the accountant to compile the schedule as supplementary information. In doing so, the accountant must include an other-matter paragraph in the compilation report addressing the compilation of the supplementary information.
- D. Incorrect. The schedule is not a financial statement. Therefore, it should not be treated as a financial statement such as a balance sheet or income statement. Thus, the answer is incorrect.
13. A. Incorrect. Although a compilation engagement and issuance of a traditional compilation report is an option, it is not a good alternative because a compilation report must be issued. Management use only financial statements do not require a report under current standards.
- B. **Correct.** The performance of a preparation of financial statements engagement under AR-C 70 may offer the best alternative to SSARS No. 19’s management use only financial statements option. The primary reason is because both engagements do not require a report to be issued. Moreover, the preparation of financial statements engagement under AR-C 70 may be issued to third parties while the management use only engagement may not.
- C. Incorrect. Upgrading to a review engagement does not appear to be the best alternative because it results in more work than a management use only engagement and results in a report being issued.
- D. Incorrect. The author suggests that there is a viable alternative which is to perform a preparation of financial statements engagement.
14. A. **Correct.** The accountant should document that he or she has an engagement letter signed by both the accountant and management.
- B. Incorrect. Analytical procedures and the documentation of those procedures are part of a review engagement and do not have to be performed in a compilation engagement. Thus, the answer is incorrect.
- C. Incorrect. Inquiries of management and others and the documentation of those inquiries are not required in a compilation engagement but are required in a review engagement, making the answer incorrect.
- D. Incorrect. A management representation letter is not required in a compilation engagement, and thus is not included in the documentation in a compilation engagement. The answer is incorrect.

15. A. Incorrect. AR-C 80 does not provide for disclosing the required supplementary information only making the answer incorrect.
- B. Incorrect. Although SSARS No. 21 does, in fact, list certain situations in which an emphasis-of-matter paragraph is required, using it in a required supplementary information situation is not one of them. Thus, the answer is incorrect.
- C. **Correct.** AR-C 80 state that if there is required supplementary information, such as that required for common interest realty associations, an other-matter paragraph should be included in the compilation report with language to explain certain information.
- D. Incorrect. AR-C 80 does require that something be done by including an other-matter paragraph, making the answer incorrect.

# Chapter 5

## AR-C Section 90

### *Review of Financial Statements*

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#### **Learning Objectives**

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- Identify the term used for the date the accountant grants an entity permission to use the accountant's review report in connection with financial statements
- Discern who should sign the engagement letter in a review engagement
- Recognize examples of unusual or complex situations that an accountant should consider when making inquiries in a review engagement
- Spot an appropriate title for an accountant's review report

#### **Introduction**

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SSARS No. 21, AR-C section 90, *Review of Financial Statements*, replaces existing AR 90 found in SSARS No. 19.

Although a significant portion of the existing rules related to review engagements that are found in AR 90 remain intact, AR-C 90 does, in fact, make several important changes, some subtle, while others far more explicit, such as a change in the review report.

AR-C 90 does the following to review engagements:

1. Establishes criteria that must be met for an accountant to accept and continue client relations in a review engagement
2. Requires that the engagement letter for a review engagement be signed by both the accountant and the client
3. Adds a new suggested review engagement letter format
4. Modifies the list of items that must be documented in a review engagement
5. Inserts the requirement that an accountant should perform a review engagement with professional skepticism
6. Includes a requirement that the accountant should communicate with management or those charged with governance on a timely basis during the course of the review engagement, all matters concerning the review engagement that are of significant importance
7. Adds language to clarify that an accountant may perform audit procedures during a review engagement and the engagement remains a review, and not an audit engagement
8. Expands examples of analytical procedures and provides additional language that clarifies that the accountant must develop expectations in performing analytical procedures
9. Expands the list of examples of inquiries that an accountant may make of management in a review engagement

10. Includes a new explicit requirement that the accountant should obtain evidence that the financial statements agree or reconcile with the accounting records
11. Carries over to review standards certain elements and terminology found in the new auditing standards, such as:
  - a. Replaces the concept of “illegal acts” with “noncompliance with laws and regulations” consistent with the changes made to auditing standards
  - b. Inserts into the SSARSs the new special purpose framework definition (including a new definition of “tax basis”) that is presently in auditing standards
  - c. Adds a new management representation letter, and a new requirement for management to attach to the representation letter a summary of uncorrected misstatements that are immaterial
  - d. Introduces a new “other-matter” paragraph in a review report, consistent with this addition in an audit report
12. Introduces a new review report that includes headings and expanded language, consistent with some of the changes made to the audit report
13. Provides better guidance regarding when an accountant should date the review report
14. Clarifies the reporting options with respect to supplementary information in a review engagement, including the option to compile, review or disclaim supplementary information
15. Includes expanded requirements and guidance in dealing with other accountants who have audited or reviewed financial statements of significant components, and
16. Eliminates the requirement that a legend be placed on each page of the financial statements such as “*See Independent Accountant's Review Report.*”

### **Scope of AR-C 90—Review of Financial Statements**

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Paragraphs 1 and 2 of AR-C 90 establish the scope for the application of AR-C 90 to review engagements.

1. AR-C 90 applies to the following engagements:
  - a. Engagements to review financial statements
  - b. Engagements to review other historical financial information.

Examples of other historical financial information that an accountant may be engaged to review include but are not limited to the following:

- Specified elements, accounts, or items of a financial statement such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information, and
- Financial information contained in a tax return.

Note: The accountant may review a single financial statement, such as a balance sheet, and not other related financial statements, such as the statements of income, retained earnings, and cash flows, if the scope of the accountant’s inquiry and analytical procedures have not been restricted.

In reviewing the list of financial information for which an accountant may perform a review engagement, that list does not include prospective information. An accountant is permitted to compile prospective information but is not permitted to review prospective information. The primary reason is because it is difficult to provide negative assurance on prospective information.

2. AR-C 90 does not apply when the accountant is engaged to review interim financial information in accordance with AU-C 930, *Interim Financial Information*, which applies when:
  - a. the entity's latest annual financial statements have been audited by the accountant or a predecessor
  - b. the accountant either:
    - has been engaged to audit the entity's current year financial statements, or
    - audited the entity's latest annual financial statements and, in situations in which it is expected that the current year financial statements will be audited, the engagement of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review, and
  - c. the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

### Effective Date

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AR-C 90 is effective for reviews of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

### Objective

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AR-C 90 carries over from existing AR 90 the general objective of a review engagement.

The objective of the accountant when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, primarily through the performance of inquiry and analytical procedures.

### Definitions

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For purposes of AR-C 90 of SSARS No. 21, the following terms have the meanings attributed as follows:

**Analytical procedures:** Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

**Applicable financial reporting framework:** The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

**Comparative financial statements:** A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

**Designated accounting standard setter:** A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to the *Compliance With Standards Rule* (AICPA, *Professional Standards*, ET sec. 1.310.001), and the *Accounting Principles Rule* (AICPA, *Professional Standards*, ET sec. 1.320.001), of the AICPA Code of Professional Conduct.

**Emphasis-of-matter paragraph:** A paragraph included in the accountant's review report that is required by SSARSs, or is included at the accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.



**Error:** Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

**Experienced accountant:** An individual (whether internal or external to the firm) who has practical review experience, and a reasonable understanding of

- review processes;
- SSARSs and applicable legal and regulatory requirements;
- the business environment in which the entity operates; and
- review and financial reporting issues relevant to the entity’s industry.

**Financial reporting framework:** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements, for example, U.S. generally accepted accounting principles, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework.

**Financial statements:** A structured representation of historical financial information, including related notes, intended to communicate an entity’s economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but can also refer to a single financial statement.

**Fraud:** An intentional act that results in a misstatement in financial statements.

**Generally accepted accounting principles (GAAP):** Reference to GAAP in SSARSs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), and Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01), of the AICPA Code of Professional Conduct.

**Historical financial information:** Information expressed in financial terms regarding a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

**Management:** The person(s) with executive responsibility for the conduct of the entity’s operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board or an owner-manager.

**Misstatement:** A difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be presented fairly in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error. Misstatements also include those adjustments of amounts, classifications, presentations, or disclosures that, in the accountant’s professional judgment, are necessary for the financial statements to be presented fairly, in all material respects.

**Noncompliance:** Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Non-compliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

**Other-matter paragraph:** A paragraph included in the accountant’s review report that is required by SSARSs, or is included at the accountant’s discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant’s judgment, is relevant to users’ understanding of the review, the accountant’s responsibilities, or the accountant’s review report.

**Report release date:** The date the accountant grants the entity permission to use the accountant’s review report in connection with the financial statements.

**Required supplementary information:** Information that a designated accounting standard setter requires to accompany an entity’s basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of that information have been established.

**Review documentation:** The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as *working papers* or *workpapers* are also sometimes used).

**Review evidence:** Information used by the accountant to provide a reasonable basis for the obtaining of limited assurance.

**Special purpose framework:** A financial reporting framework other than GAAP that is one of the following bases of accounting:

- **Cash basis:** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- **Tax basis:** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- **Regulatory basis:** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).
- **Contractual basis:** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- **Other basis:** A basis of accounting that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting (OCBOA)*.

**Specified parties:** The intended users of the accountant’s review report.

**Subsequent events:** Events occurring between the date of the financial statements and the date of the accountant’s review report.

**Subsequently discovered facts:** Facts that become known to the accountant after the date of the accountant’s review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant’s review report.

**Supplementary information:** Financial information presented outside the financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework.

**Those charged with governance:** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel, for example, executive members of a governance board or an owner manager.

**Updated report:** A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant’s current engagement and that re-expresses the accountant’s previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant’s current report.

**Written representation:** A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements or supporting books and records.

## **Requirements for Performing a Review Engagement Under AR-C 90**

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AR-C 90 carries over many, but not all, of the existing requirements found in AR-90 related to review engagements. Those requirements are as follows.

In performing a review engagement, the accountant must:

- Follow the General Principles found in AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*
- Be independent
- Satisfy preconditions for acceptance and continuance of client relationships and review engagements, including executing an engagement letter
- Communicate with management and those charged with governance matters of significant importance
- Understand the industry
- Obtain knowledge of the entity
- Design and perform review procedures including analytical procedures and inquiries
- Reconcile the financial statements to the underlying accounting records
- Evaluate evidence obtained from the review procedures performed
- Obtain written representations from management (management representation letter), and
- Report on the financial statements

Following are the overall requirements to perform a review engagement under the new AR-C 90.

### **General Principles for Performing and Reporting on Review Engagements**

In addition to complying with the rules in AR-C 90 pertaining to a review engagement, an accountant must comply with the requirements in AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

#### **Independence**

The accountant must be independent of the entity when performing a review of financial statements in accordance with SSARs.

1. If, during the performance of the review engagement, the accountant determines that the accountant's independence is impaired, the accountant should withdraw from the review engagement.

**Note:** The AICPA Code of Professional Conduct provides guidance with respect to independence.

2. Nothing prohibits an accountant who is unable to complete a review engagement due to a determination that the accountant's independence is impaired from performing a compilation engagement on those financial statements, provided the lack of independence is reflected in the accountant's compilation report.

**Preconditions: Acceptance and Continuance of Client Relationships and Review Engagements**

In order for an accountant to perform a review engagement, the accountant must satisfy certain preconditions found in AR-C 90:

1. The accountant should not accept a review engagement if:
  - a. Any of the following conditions found in paragraph .24 of the general conditions in AR-C 60 exist as follows:
    - 1) The accountant has reason to believe that relevant ethical requirements will not be satisfied
    - 2) The accountant's preliminary understanding of the engagement circumstances indicates that the information needed to be perform the engagement is likely to be unavailable or unreliable, and
    - 3) The accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.
  - b. Management or those charged with governance imposes a limitation on the scope of the accountant's work in terms of a proposed review engagement such that the accountant believes the limitation will result in the accountant being unable to perform review procedures to provide an adequate basis for issuing a review report.
2. As a condition for accepting an engagement to review an entity's financial statements, an accountant must satisfy certain conditions as follows:
  - a. Satisfy the conditions found in paragraphs .25(a), (b) and (c.) of the general principles, in AR-C 60 as follows:
    - 1) Determine whether preliminary knowledge of the engagement circumstances indicate that ethical requirements regarding professional competence (including independence) will be satisfied
    - 2) Determine whether the financial reporting framework selected by management is acceptable
    - 3) Obtain an agreement with management that it acknowledges and understands management's responsibilities for:
      - Selection of the financial reporting framework
      - Design, implementation, and maintenance of internal control
      - Preventing and detecting fraud
      - Ensuring that the entity complies with laws and regulations applicable to its activities
      - The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements, and
      - Providing the accountant with access to all relevant information and additional information that may be requested by the accountant, and unrestricted access to persons within the entity for necessary inquiry.
  - b. Obtain an agreement with management that it acknowledges and understands that management is responsible for:
    - 1) The preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are

appropriate for the applicable financial reporting framework used to prepare the entity's financial statements

- 2) To provide the accountant with at the conclusion of the engagement, a letter that confirms certain representations made during the review (management representation letter), and
- 3) To include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by the entity's accountant unless a different understanding is reached.

**Note:** Documents containing financial statements that may include an indication that such financial statements have been reviewed by the entity's accountant includes documents submitted to bonding companies.

c. Additional requirements for a special purpose framework:

If the financial statements are prepared in accordance with a special purpose framework, the fair presentation of the financial statements must include:

- A description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP
- A description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual basis of accounting, and
- Additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.

**Note:** If the accountant is not satisfied about any of the matters for accepting a review engagement, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

### **Engagement Letter—Review Engagement**

The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate.

1. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following:
  - a. The objectives of the engagement
  - b. The responsibilities of management
  - c. The responsibilities of the accountant
  - d. The limitations of a review engagement
  - e. Identification of the applicable financial reporting framework for the preparation of the financial statements
  - f. The expected form and content of the accountant's review report, and a statement that there may be circumstances in which the report may differ from its expected form and content
2. The engagement letter or other suitable form of written communication should be signed by:
  - a. the accountant or the accountant's firm, and
  - b. management or those charged with governance, as appropriate.

**Note:** When the agreement on the terms of engagement is only with those charged with governance, the accountant is required to also obtain management's agreement that it acknowledges and understands its responsibilities.

When a third party has contracted for a review of the entity’s financial statements, the accountant must also obtain management’s agreement with the terms of the review in order to establish that the preconditions for a review are present.

3. A contract may be used as a suitable form of written communication. A verbal understanding is insufficient.

## Illustrative Engagement Letters

### Illustration 1—An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance With U.S. GAAP and to Perform a Review Engagement With Respect to Those Financial Statements

#### Facts:

- The accountant is hired to prepare, as a nonattest service, the financial statements, including related notes.
- The accountant is also hired to perform a review engagement on the same financial statements that are prepared.
- U.S. GAAP is the applicable framework.

To the appropriate representative of management of ABC Company:

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders’ equity, and cash flows for the year then ended, and the related notes to the financial statements and perform a review engagement with respect to those financial statements.<sup>1</sup> We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (a)

#### Our Responsibilities

The objective of our engagement is to:

- a. Prepare financial statements in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and
- b. Obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA’s Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit

<sup>1</sup> The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is the preparation of financial statements in accordance with accounting principles generally accepted in the United States of America and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- i. To include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us.

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295—Nonattest Services] (b)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *“See Independent Accountant’s Review Report.”*(c)

*[Insert appropriate reference to the expected form and content of the accountant’s review report. Example follows]*

We will issue a written report upon completion of our review of ABC Company’s financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant’s review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

**Other relevant information**

Our fees for these services. . .

*[The accountant may include language such as the following regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, defend, us from any liability or costs, including attorney’s fees, resulting from management’s knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review of those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant or accountant’s firm]*

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
*[Signed]*  
*[Name and title]*

\_\_\_\_\_  
*[Date]*



- (a) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (b) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (review engagement), the accountant is required to include language in the engagement letter in accordance with ET section 1.295 of AICPA Professional Standards, to remain independent.
- (c) The legend “*See Independent Accountant’s Review Report*” or similar language, is no longer required by AR-C 90. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management should agree to it within the engagement letter.

**Illustration 1A—An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance With the Tax Basis of Accounting and to Perform a Review Engagement With Respect to Those Financial Statements**

**Facts:**

- The accountant is hired to prepare, as a nonattest service, the financial statements, including related notes.
- The accountant is also hired to perform a review engagement on the same financial statements that are prepared.
- Tax basis is the applicable framework.

To the appropriate representative of management of ABC Company:<sup>2</sup>

You<sup>3</sup> have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet—tax basis as of December 31, 20XX, and the related statements of income and retained earnings—tax basis, and cash flows—tax basis for the year then ended, and the related notes to the financial statements, and perform a review engagement with respect to those financial statements.<sup>4</sup> We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (a)

**Our Responsibilities**

The objective of our engagement is to

Prepare financial statements in accordance with the tax basis of accounting based on information provided by you, and

<sup>2</sup> The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons.

<sup>3</sup> Throughout this engagement letter, references to you, we, us, management, and accountant would be used or amended as appropriate in the circumstances.

<sup>4</sup> The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

Obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

### **Your Responsibilities**

The engagement to be performed is conducted on the basis that you acknowledge and understands that our role is the preparation of financial statements in accordance with the tax basis of accounting and to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the tax basis of accounting. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.

- g. The preparation and fair presentation of the financial statements in accordance with the tax basis of accounting and the inclusion of all informative disclosures that are appropriate for the tax basis of accounting. That includes:
- a description of the tax basis of accounting, including a summary of significant accounting principles, and how the tax basis of accounting differs from accounting principles generally accepted in the United States of America, the effects of which need not be quantified.
  - informative disclosures similar to those required by accounting principles generally accepted in the United States of America.
  - additional disclosures beyond those required by the tax basis of accounting that may be necessary for the tax basis of accounting to achieve fair presentation. (d)
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- i. To include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us.

You are also responsible for all management decisions and responsibilities, and for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295—Nonattest Services] (b)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Independent Accountant's Review Report."*(c)

*[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows]*

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from the tax basis of accounting, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the engagement. If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

**Other relevant information**

Our fees for these services. . .

*[The accountant may include language such as the following regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, defend, us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein and to perform a review of those same financial statements, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
[Signed]  
[Name and title]

\_\_\_\_\_  
[Date]

- (a) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (b) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (review engagement), the accountant is required to include language in the engagement letter in accordance with ET section 1.295 of AICPA Professional Standards, to remain independent.
- (c) The legend “*See Independent Accountant's Review Report*” or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management must agree to it within the engagement letter.
- (d) If a special purpose framework is used (such as tax basis financial statements), management must take responsibility for the fair presentation of the financial statements that includes:
  - A description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified
  - Informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, and
  - Additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.

**Illustration 2—An Engagement Letter for a Review Engagement With Respect to Financial Statements (Prepared By the Client) in Accordance With U.S. GAAP**

**Facts:**

- The client, rather than the accountant, prepares the financial statements.
- The accountant is hired to perform a review engagement on the same financial statements that the client prepared.
- U.S. GAAP is the applicable framework.

To the appropriate representative of management of ABC Company:<sup>5</sup>

You<sup>6</sup> have requested that we perform a review engagement with respect to the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements.<sup>7</sup> We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (a)

**Our Responsibilities**

The objective of our engagement is to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including ethical principles of integrity, objectivity, professional competence, and due care.

A review engagement includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement. Accordingly, we will not express an opinion regarding the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by error or fraud, or to identify or disclose any wrongdoing within the entity or

<sup>5</sup> The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the review engagement, including the relevant jurisdiction. It is important to refer to the appropriate persons.

<sup>6</sup> Throughout this engagement letter, references to you, we, us, management, and accountant would be used or amended as appropriate in the circumstances.

<sup>7</sup> The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

noncompliance with laws and regulations. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding noncompliance with laws and regulations that may have occurred, unless they are clearly inconsequential.

### **Your Responsibilities**

The review engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement
- f. To provide us with:
  - Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within ABC Company to whom we determine necessary to communicate.
- g. The preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America
- h. To provide us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- i. To include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by us.

You are also responsible for including the following reference on each page of the financial statements including supplementary information: *"See Independent Accountant's Review Report."*(c)

*[Insert appropriate reference to the expected form and content of the accountant's review report. Example follows]*

We will issue a written report upon completion of our review of ABC Company's financial statements. Our report will be addressed to the board of directors of ABC Company. We cannot provide assurance that an unmodified accountant's review report will be issued. Circumstances may arise in which it is necessary for us to report known departures from accounting principles generally accepted in the United States of America, add an emphasis-of-matter or other-matter paragraph(s), or withdraw from the

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

**Other relevant information**

Our fees for these services. . .

*[The accountant may include language such as the following regarding limitation of or other arrangements regarding the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements):*

*You agree to hold us harmless and to release, indemnify, defend, us from any liability or costs, including attorney’s fees, resulting from management’s knowing misrepresentations to us.]*

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to perform a review with respect to the financial statements described herein and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant or accountant’s firm]*

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
*[Signed]*  
*[Name and title]*

\_\_\_\_\_  
*[Date]*

- (a) If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement. Alternatively, the additional nonattest services could be included in a separate engagement letter.
- (b) Because a nonattest service (preparation of financial statements) is performed for an attest engagement (review engagement), the accountant is required to include language in the engagement letter in accordance with ET section 1.295 of AICPA Professional Standards, to remain independent.
- (c) The legend “*See Independent Accountant’s Review Report*” or similar language, is not required. Because the financial statements are the responsibility of management, if an accountant wishes to include the legend on each page of the financial statements (including supplementary information), management must agree to it within the engagement letter.

**Communication with Management and Those Charged With Governance**

The accountant should communicate with management or those charged with governance, as appropriate, on a timely basis during the course of the review engagement, all matters concerning the review engage-

ment that, in the accountant’s professional judgment, are of significant importance to merit the attention of management or those charged with governance.

1. In a review engagement, the accountant’s communications with management and those charged with governance take the form of:
  - a. Inquiries the accountant makes in the course of performing the procedures for the review, and
  - b. Other communications, in the context of having effective two-way communication to understand matters arising and to develop a constructive working relationship for the engagement.
2. The appropriate timing for communications will vary with the circumstances of the engagement based on relevant factors that include:
  - a. the significance and nature of the matter, and
  - b. any action expected to be taken by management or those charged with governance.

**Example:** It may be appropriate to communicate a significant difficulty encountered during the review as soon as practicable if management or those charged with governance are able to assist the accountant to overcome the difficulty.

**Note:** A particular law or regulation may restrict the accountant’s communication of certain matters with those charged with governance. By way of example, a law or regulation may specifically prohibit a communication, or other action, that might prejudice an investigation by an appropriate authority into an actual, or suspected, illegal act. In some circumstances, potential conflicts between the accountant’s obligations of confidentiality and obligations to communicate may be complex. In such cases, the accountant may consider obtaining legal advice.

### Communicating Matters Concerning the Review

Matters to be communicated to management or those charged with governance in a review engagement may include:

- The accountant’s responsibilities in the review engagement, as included in the engagement letter or other suitable form of written agreement
- Significant findings from the review, for example:
  - The accountant’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures
  - Significant findings from the performance of procedures, including situations where the accountant considered performance of additional procedures necessary in accordance with this section. The accountant may need to confirm that those charged with governance have the same understanding of the facts and circumstances relevant to specific transactions or events
  - Matters arising that may lead to modification of the accountant’s review report, and
  - Significant difficulties, if any, encountered during the review; for example, unavailability of expected information; unexpected inability to obtain evidence that the accountant considers necessary for the review; or restrictions imposed on the accountant by management. In some circumstances, such difficulties may lead to the accountant’s withdrawal from the engagement.

**Note:** In some entities, different individuals may be responsible for the management and the governance of an entity. In these circumstances, management may have the responsibility to communicate certain matters to those charged with governance. Communication by management with those charged with governance of matters that the accountant is required to communicate does not relieve the accountant of the responsibility to also communicate with those charged with governance. However, communication of these matters by management may affect the form or timing of the accountant’s communication with those charged with governance.



### Communication with Third Parties

The accountant may be required by law or regulation to, for example:

- Notify a regulatory or enforcement body of certain matters communicated with those charged with governance, and
- Submit copies of certain reports prepared for those charged with governance to relevant regulatory or funding bodies or, in some cases, make such reports publicly available.

Unless required by law or regulation to provide a third party with a copy of the accountant's written communications with those charged with governance, the accountant may need the prior consent of management or those charged with governance before doing so.

### Understanding of the Industry

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In order to perform the review engagement, the accountant should possess or obtain an understanding of the industry in which the entity operates, including the accounting principles and practices generally used in the industry, sufficient to enable the accountant to review financial statements that are appropriate for an entity operating in that industry.

**Note:** AR-C 90 states that the requirement that the accountant possess a level of knowledge of the industry in which the entity operates does not prevent the accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals knowledgeable about the industry.

### Knowledge of the Entity

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The accountant should obtain knowledge about the entity sufficient to identify areas in the financial statements where there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas.

1. Such knowledge should include an understanding of:
  - a. the entity's business, including a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues and expenses, and
  - b. the accounting principles and practices used by the entity.
2. In obtaining the understanding of the entity's accounting policies and practices, the accountant should be alert to accounting policies and procedures that, based on the accountant's knowledge of the industry are unusual.
3. The accountant may obtain knowledge of the entity through inquiry of the entity's personnel, the review of documents prepared by the entity, or experience with the entity or the entity's industry. Such knowledge includes the following:
  - An understanding of the entity's business, and
  - An understanding of the accounting principles and practices used by the entity in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements.

### Designing and Performing Review Procedures

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AR-C 90 provides procedures that an accountant should perform in a review engagement:

1. The accountant should design and perform analytical procedures and make inquiries and perform other procedures, as needed, to obtain limited assurance as to whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework based on the accountant's:
  - a. understanding of the industry
  - b. knowledge of the entity, and
  - c. awareness of the risk that the accountant may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated.
2. The accountant should focus the analytical procedures and inquiries in those areas in which the accountant believes there are increased risks of material misstatements.
3. In addition to analytical procedures and inquiries, in certain circumstances and based on the accountant's professional judgment, the accountant may perform procedures ordinarily performed in an audit. In such instances, the engagement remains a review, and the accountant is not required to perform an audit of the financial statements.
4. The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that a related party transaction is not disclosed may revise the accountant's awareness of risk relative to related party transactions.

## **Analytical Procedures**

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The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement.

1. Such analytical procedures should include the following:
  - a. Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions
  - b. Considering plausible relationships among both financial and, when relevant, nonfinancial information
  - c. Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates, and
  - d. Comparing disaggregated revenue data, as applicable.
2. When designing and performing analytical procedures, the accountant should:
  - a. determine the suitability of particular analytical procedures
  - b. consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available
  - c. develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated, and
  - d. determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

**Note:** Various methods may be used to perform analytical procedures. These methods range from performing simple comparisons to performing complex analyses. Analytical procedures may be performed at the financial statement level or at the detailed account level. The nature, timing, and extent of analytical procedures are a matter of professional judgment.

3. Examples of analytical procedures that an accountant may consider performing when conducting a review of financial statements are contained in Appendix A noted below which is extracted from SSARS No. 21.

### **Appendix A—Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements**

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. Examples of analytical procedures that an accountant may consider performing in a review of financial statements include the following:

- Comparing current financial statements with the financial statements of the prior period.
- Comparing current financial statements with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial statements with corresponding information in [a] budgets, using expected rates, and [b] financial statements for prior periods). Caution is necessary when comparing and evaluating current financial statements with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.
- Comparing current financial statements with relevant nonfinancial information.
- Comparing ratios and indicators for the current period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current financial statements and comparing the results with corresponding information for prior periods). Examples of key ratios and indicators are the current ratio, receivable turnover or days sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial statements with corresponding relationships in the financial statements of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables).
- Comparing disaggregated data. The following are examples of how data may be disaggregated:
  - By period (for example, financial statement items disaggregated into quarterly, monthly, or weekly amounts)
  - By product line or operating segment
  - By location (for example, subsidiary, division, or branch)

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

### Investigating Results of Analytical Procedures

If analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant should investigate such differences by:

- inquiring of management, and
- performing other review procedures if considered necessary in the circumstances.

Although the accountant is not required to corroborate management's responses with other evidence, the need to perform other review procedures may arise when, for example, management is unable to provide an explanation or the explanation is not considered adequate.

### Inquiries of Members of Management Who Have Responsibility for Financial and Accounting Matters

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Inquiries, along with analytical procedures are critical to the successful completion of a revenue engagement.

AR-C 90 provides the following requirements in performing inquiries. Items noted in **bold** are added by SSARS No. 21 and were not included in the list of inquiries in SSARS No. 19.

1. The accountant should inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about:
  - a. whether the financial statements have been prepared and fairly presented in accordance with the applicable financial reporting framework consistently applied
  - b. unusual or complex situations that may have an effect on the financial statements
  - c. significant transactions occurring or recognized during the period, particularly those in the last several days of the period
  - d. the status of uncorrected misstatements identified during the previous review (that is, whether adjustments had been recorded subsequent to the periods covered by the prior review and, if so, the amounts recorded and period in which such adjustments were recorded)
  - e. matters about which questions have arisen in the course of applying the review procedures
  - f. events subsequent to the date of the financial statements that could have a material effect on the fair presentation of such financial statements
  - g. its knowledge of any fraud or suspected fraud affecting the entity involving (1) management, (2) employees who have significant roles in internal control, or (3) others when the fraud or suspected fraud could have a material effect on the financial statements.

Note: Management may obtain knowledge of fraud or suspected fraud affecting the entity involving management or others when the fraud could have a material effect on the financial statements through, among other things, communications received from employees, former employees, or others.
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- h. **whether management is aware of allegations of fraud or suspected fraud affecting the entity communicated by employees, former employees, regulators, or others NEW**
- i. **that management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements NEW**
- j. significant journal entries and other adjustments
- k. communications from regulatory agencies, if applicable
- l. **related parties and significant new related party transactions NEW**
- m. **any litigation, claims, and assessments that existed at the date of the balance sheet being reported on and during the period from the balance sheet date to the date of management's response to the accountant's inquiry NEW**

- n. **whether management believes that significant assumptions used by it in making accounting estimates are reasonable NEW**
  - o. actions taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements, and
  - p. **any other matters that the accountant may consider necessary. NEW**
2. In performing inquiries, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business. However, the accountant is not required to corroborate management's responses with other evidence.
  3. In addition to members of management who have responsibility for financial and accounting matters, the accountant may determine to direct inquiries to others within the entity and those charged with governance, if appropriate.
  4. Examples of unusual or complex situations about which the accountant may inquire of management are contained in Appendix B below, which is extracted from SSARS No. 21 by the author.

**Appendix B—Unusual or Complex Situations to Be Considered by the Accountant When Considering Inquiries in a Review of Financial Statements**

The following are examples of situations about which the accountant may inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior periods
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates, such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related party transactions
- Material off-balance-sheet transactions, special purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

## **Reading the Financial Statements**

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As part of a review engagement, an accountant should read the financial statements and consider whether any information has come to the accountant's attention to indicate that such financial statements do not conform to the applicable financial reporting framework.

## **Using the Work of Other Accountants**

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If other accountants have issued a report on the financial statements of significant components, such as subsidiaries and investees, the accountant should obtain and read reports from such other accountants.

## **Reconciling the Financial Statements to the Underlying Accounting Records**

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AR-C 90 adds a new requirement in a review engagement where the accountant should obtain evidence that the financial statements agree or reconcile with the accounting records.

To obtain evidence that the financial statements agree or reconcile with the accounting records, the accountant may compare the financial statements to:

- the accounting records, such as the general ledger
- a consolidating schedule derived from the accounting records, or
- other supporting data in the entity's records

## **Evaluating Evidence Obtained From the Procedures Performed**

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As part of the review engagement, the accountant should accumulate misstatements, including inadequate disclosures, identified by the accountant in performing the review procedures or brought to the accountant's attention during the performance of the review.

1. The accountant should evaluate, individually and in the aggregate, misstatements, including adequate disclosure, accumulated to determine whether material modification should be made to the financial statements for them to be in accordance with the applicable financial reporting framework.

Considerations that may affect the evaluation of whether uncorrected misstatements, individually or in the aggregate, are material include the following:

- The nature, cause (if known), and amount of the misstatements
  - Whether the misstatements originated in the preceding year
  - The potential effect of the misstatements on future periods
  - The appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement, and
  - Recognition that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods.
2. If, during the performance of review procedures, the accountant becomes aware that information coming to the accountant's attention is incorrect, incomplete, or otherwise unsatisfactory the accountant should:
    - a. request that management consider the effect of those matters on the financial statements and communicate the results of its consideration to the accountant, and
    - b. consider the results communicated to the accountant by management and whether such results indicate that the financial statements may be materially misstated.
  3. If the accountant believes that the financial statements may be materially misstated, the accountant should perform additional procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework.

4. The accountant should evaluate whether sufficient appropriate review evidence has been obtained from the procedures performed and, if not, the accountant should perform other procedures judged by the accountant to be necessary in the circumstances to be able to form a conclusion on the financial statements.

In some circumstances, the accountant may not have obtained the evidence that the accountant had expected to obtain through the design of primarily inquiry and analytical procedures and procedures addressing specific circumstances. In these circumstances, the accountant considers that the evidence obtained from the procedures performed is not sufficient and appropriate to be able to form a conclusion on the financial statements. The accountant may:

- Extend the work performed, or
- Perform other procedures judged by the practitioner to be necessary in the circumstances.

**Note:** Where neither of the above actions is practicable in the circumstances, the accountant will not be able to obtain sufficient appropriate evidence to be able to form a conclusion and is required by this section to determine the effect on the accountant's ability to complete the engagement. This situation may arise even though the accountant has not become aware of a matter(s) that causes the accountant to believe the financial statements may be materially misstated.

## Materiality

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In a review engagement, the accountant's consideration of materiality is made in the context of the applicable financial reporting framework.

1. Although financial reporting frameworks may discuss materiality in different terms, most generally explain materiality in the following content:
  - a. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements
  - b. Judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement or a combination of both, and
  - c. Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.
2. The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the needs of the intended users of the financial statements. In this context, it is reasonable for the accountant to assume that users:
  - have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence
  - understand that financial statements are prepared, presented, and reviewed to levels of materiality
  - recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events, and
  - make reasonable economic decisions on the basis of the information in the financial statements.
3. Unless the review engagement is undertaken for financial statements that are intended to meet the particular needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.
4. The accountant's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by the accountant as a basis for expressing a conclusion on the financial statements.

5. The accountant’s determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of:
  - a change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity’s business).
  - new information, or a change in the accountant’s understanding of the entity and its environment as a result of performing review procedures (for example, if during the review it appears actual financial results are likely to be substantially different from anticipated period-end financial results that were used initially to consider materiality for the financial statements as a whole).

## **Written Representations in a Review Engagement**

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### **Written Representations as Review Evidence**

Written representations are review evidence that are necessary information that the accountant requires in connection with a review of the entity’s financial statements.

If management modifies or does not provide the requested written representations, it may alert the accountant to the possibility that one or more significant issues may exist. Further, a request for written rather than oral representations, in many cases, may prompt management to consider such matters more rigorously, thereby enhancing the quality of the representations.

### **Management From Whom Written Representations Are Requested**

The accountant should request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

1. Written representations should be requested from those with overall responsibility for financial and operating matters whom the accountant believes are responsible for, and knowledgeable about, directly or through others in the organization, the matters covered by the representations, including the preparation and fair presentation of the financial statements.
  - Written representations may be requested from the entity’s CEO and CFO or other equivalent persons in entities who do not use such titles.
  - Other parties, such as those charged with governance, also are responsible for the preparation and fair presentation of the financial statements.
2. Due to its responsibility for the preparation and fair presentation of the financial statements and its responsibility for the conduct of the entity’s business, management is expected to have sufficient knowledge of the process followed by the entity in preparing the financial statements on which to base the written representations.
3. In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the accountant to accept such wording if, in the accountant’s judgment, the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

### **Specific Written Representations**

AR-C 90 provides a list of specific written representations that an accountant must obtain from management as part of a review engagement:

1. For all financial statements presented and for all periods covered by the review, the accountant should request management to provide written representations, that are dated as of the date of the accountant’s review report:



- a. that management has fulfilled its responsibility for the preparation and fair presentation of the financial statements, in accordance with the applicable financial reporting framework, as set out in the terms of the engagement
- b. that management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud
- c. that management has provided the accountant with all relevant information and access, as agreed upon in the terms of the engagement
- d. that management has responded fully and truthfully to all of the accountant's inquiries
- e. that all transactions have been recorded and are reflected in the financial statements
- f. that management has disclosed to the accountant its knowledge of fraud or suspected fraud affecting the entity involving:
  - management,
  - employees who have significant roles in internal control, or
  - others when the fraud could have a material effect on the financial statements.
- g. that management has disclosed to the accountant its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others
- h. that management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements
- i. about whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole

**Note:** A summary of such items should be included in, or attached to, the written representation.

- j. that management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework
- k. about whether management believes that significant assumptions used by it in making accounting estimates are reasonable
- l. that management has disclosed to the accountant the identity of the entity's related parties and all of the related party relationships and transactions of which it is aware and it has appropriately accounted for and disclosed such relationships and transactions, and
- m. that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

**Note:** Review evidence obtained during the review that management has acknowledged the responsibilities referred to in (a) and (b) above is not sufficient without obtaining representation from management that it believes that it has fulfilled those responsibilities. This is because the accountant is not able to judge solely on other review evidence whether management has prepared and fairly presented the financial statements and provided information to the accountant on the basis of the agreed acknowledgment and understanding of its responsibilities.

SSARS No. 21 expands the written representations relating to fraud. These representations, found in (1) (f) and (g) above, are important for the accountant to obtain, regardless of the size of the entity, because of the nature of fraud and the difficulties encountered by accountants in detecting material misstatements in the financial statements resulting from fraud.

2. If, in addition to the specific representations required by the previous paragraph, the accountant determines that it is necessary to obtain one or more written representations to support other review evidence relevant to the financial statements, the accountant should request such other written representations.
3. Because the preparation of financial statements requires management to adjust the financial statements to correct material misstatements, the accountant is required to request management to provide a written representation about uncorrected misstatements.

In some circumstances, management may not believe that certain uncorrected misstatements are misstatements. For that reason, management may want to add to their written representation words such as:

*“We do not agree that items ... and ... constitute misstatements because [description of reasons].”*

4. Circumstances in which it may be appropriate to obtain written representations about related parties from those charged with governance in addition to management include the following:
  - When they have approved specific related party transactions that (a) materially affect the financial statements or (b) involve management
  - When they have made specific oral representations to the accountant on details of certain related party transactions, and
  - When they have financial or other interests in the related parties or the related party transactions.
5. The written representations should have an “as of” date which is the same as the date of the accountant’s review report on the financial statements.

**Note:** Because written representations are necessary review evidence, the accountant has not obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework, and the accountant’s review report cannot be dated, before the date of the written representations.

6. The written representations cover all periods referred to in the accountant’s review report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The accountant and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

**Note:** Situations may arise in which current management was not present during all periods referred to in the accountant’s review report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons’ responsibilities for the financial statements as a whole. Accordingly, the requirement for the accountant to request from them written representations that cover the whole of the relevant period(s) still applies.

7. The accountant may request additional representations regarding matters specific to the entity’s business or industry. In addition the accountant is not precluded from obtaining representations regarding services performed in addition to the review engagement.
8. The written representations should be in the form of a representation letter addressed to the accountant.

**Note:** There are circumstances that may prevent management from signing the representation letter and returning it to the accountant on the date of the accountant’s review report. In those circumstances, the accountant may accept management’s oral confirmation, on or before the date of the accountant’s review report, that management has reviewed the final representation letter and will sign the representation letter without exception as of the date of the accountant’s review report. Possession of the signed management representation letter prior to releasing the accountant’s review report is necessary because SSARS No. 21 requires that the representations be in the form of a written letter from management. Furthermore, when there are delays in releasing the report, a fact may become known to the accountant that, had it been known to the accountant at the date of the accountant’s review report, might affect the accountant’s review report and result in the need for updated representations.

**Concerns About the Reliability of Written Representations and Requested Written Representations Not Provided**

If, in relation to the written representations:

- Management does not provide the written representations, or
- The accountant concludes that there is cause to doubt management’s integrity such that the written representations provided are not reliable,

the accountant should discuss the matter with management and those charged with governance, as appropriate. If management does not provide the required representations or the accountant continues to doubt management’s integrity such that the written representations provided may not be reliable, the accountant should withdraw from the engagement.

**Illustrative Representation Letter**

(Entity Letterhead)

Date

To [Accountant]

This representation letter is provided in connection with your review of the financial statements of ABC Company, which comprise the balance sheets as of December 31, 20X6 and 20X5, and the related statements of income, changes in stockholders’ equity and cash flows for the years then ended, and the related notes to the financial statements, for the purpose of obtaining limited assurance as a basis for reporting whether you are aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with accounting principles generally accepted in the United States of America.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We represent that, *[to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves] [as of (date of accountant’s review report)]*:

**Financial Statements**

- We acknowledge our responsibility and have fulfilled our responsibilities for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America.
- We acknowledge our responsibility and have fulfilled our responsibilities for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.
- We acknowledge our responsibility for the design, implementation, and maintenance of internal control to prevent and detect fraud.
- Significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable.
- Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Guarantees, whether written or oral, under which the company is contingently liable have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America.
- Significant estimates and material concentrations known to management that are required to be disclosed in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification (ASC) 275, Risks and Uncertainties*, have been properly accounted for and disclosed in accordance with the requirements of accounting principles generally accepted in the United States of America. *[Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.]*
- All events subsequent to the date of the financial statements and for which accounting principles generally accepted in the United States of America requires adjustment or disclosure have been adjusted or disclosed.
- The effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements as a whole. *[A summary of uncorrected misstatements is attached to this letter.]*
- The effects of all known actual or possible litigation and claims have been accounted for and disclosed in accordance with accounting principles generally accepted in the United States of America.
- *[Any other matters that the accountant may consider appropriate.]*

**Information Provided**

- We have responded fully and truthfully to all inquiries made to us by you during your review.
- We have provided you with
  - access to all information, of which we are aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters;
  - minutes of meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared;
  - additional information that you have requested from us for the purpose of the review; and

- unrestricted access to persons within the entity from whom you determined it necessary to obtain review evidence.
- All transactions have been recorded in the accounting records and are reflected in the financial statements.
- We have [*no knowledge of any*][*disclosed to you all information that we are aware of regarding*] fraud or suspected fraud that affects the entity and involves
  - management,
  - employees who have significant roles in internal control, or
  - others when the fraud could have a material effect on the financial statements.
- We have [*no knowledge of any*][*disclosed to you all information that we are aware of regarding*] allegations of fraud, or suspected fraud, affecting the entity's financial statements as a whole communicated by employees, former employees, analysts, regulators or others.
- We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
- We have disclosed to you all known instances of noncompliance or suspected noncompliance with law or regulation whose effects should be considered when preparing financial statements.
- We [*have disclosed to you all known actual or possible*] [*are not aware of any pending or threatened*] litigation and claims whose effects should be considered when preparing the financial statements [*and we have not consulted legal counsel concerning litigation or claims*]
- We have disclosed to you any other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450, Contingencies.
- We have disclosed to you the identity of the entity's related parties and all the related party relationships and transactions of which we are aware.
- No material losses exist (such as from obsolete inventory or purchase or sale commitments) that have not been properly accrued or disclosed in the financial statements.
- The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
- We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
- We are in agreement with the adjusting journal entries [*and account classifications*] that you have recommended, and they have been posted to the company's accounts (if applicable).(1)

[*Any other matters that the auditor may consider necessary.*]

\_\_\_\_\_  
[*Name of Chief Executive Officer and Title*]

\_\_\_\_\_  
[*Name of Chief Financial Officer and Title*]

Representation letters ordinarily are tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

(1) In accordance with AICPA Professional Standards, ET 1.295, Nonattest Services, if an accountant performs nonattest services for an attest client, the accountant is precluded from taking management responsibility for the nonattest work. If the nonattest service involves bookkeeping services, management must approve all adjusting entries and accountant classifications. One way in which an ac-

countant might want to have his or her client sign off on the bookkeeping service is to include a statement in the management representation letter stating that management is in agreement with the adjusting entries and account classifications that the accountant has recommended.

ABC Company  
Schedule of Uncorrected Misstatements  
December 31, 20X6 and 20X5

None.

## Reporting on the Financial Statements

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AR-C 90 makes significant changes to the review report to make its format more in line with the version of the audit report under the new auditing standards.

Following is a summary of the requirements of the new review report.

1. The accountant's review report should be in writing and may be issued in a hard copy format or electronic medium.
2. The accountant may consider including (but is not required to include) a reference on each page of the reviewed financial statements to the accountant's review report.

An example of a reference to the accountant's review report included on each page of the reviewed financial statements is:

*"See Independent Accountant's Review Report."*

**Note:** Existing AR 90 requires that an accountant include a reference (legend) on each page of the reviewed financial statements such as *"See Independent Accountant's Review Report."* In AR-C 90, this requirement is eliminated even though it is recommended that the accountant include the reference on each page of the reviewed financial statements. A similar change was made for compiled financial statements where the reference to the compilation report is no longer required.

One reason why the reference (legend) is no longer mandatory for either a compilation or review engagement is because the financial statements are the responsibility of management, and not the accountant. Thus, the accountant really has no authority to require that the financial statements include a reference/legend. If the accountant does, in fact, want a legend on each page of the reviewed financial statements, the accountant should include that requirement in the engagement letter.

3. When the accountant is unable to perform the inquiry, analytical procedures, and other review procedures the accountant considers necessary in the review engagement, or management does not provide the accountant with a representation letter, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report.
4. The written review report should include:
  - a. a title that includes the word independent to clearly indicate that it is the report of an independent accountant. An appropriate title would be *"Independent Accountant's Review Report."*
  - b. an addressee as appropriate for the circumstances of the engagement.
  - c. an introductory paragraph that:
    - identifies the entity whose financial statements have been reviewed,
    - states that the financial statements identified in the report were reviewed,
    - identifies the financial statements, included the related notes,<sup>8</sup>
    - specifies the date or period covered by each financial statement,
    - includes a statement that a review includes primarily applying analytical procedures to management's (owner's) financial data and making inquiries of company management (owners), and
    - includes a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.

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<sup>8</sup> SSARS No. 21 has carried forward from auditing standards the requirement that the financial statements include "the related notes." In existing SSARS No. 19, in listing the financial statements in the first paragraph of the review report, the accountant does not identify the "related notes."

- d. a section with the heading “*Management’s Responsibility for the Financial Statements*” that includes an explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework.
- e. a section with the heading “*Accountant’s Responsibility*” that includes the following statements:
  - The accountant’s responsibility is to conduct the review engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA. The accountant’s review report should also explain that those standards require that the accountant perform the procedures to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework.
  - The accountant believes that the review evidence the accountant has obtained is sufficient and appropriate to provide a basis for the accountant’s conclusion.
- f. a concluding section with an appropriate heading “*Accountant’s Conclusion*” that includes a statement about whether the accountant is aware of any material modifications that should be made to the accompanying financial statements for them to be in accordance with the applicable financial reporting framework and that identifies the country of origin of those accounting principles, if applicable.
- g. the manual or printed signature of the accountant’s firm.
- h. the city and state where the accountant practices.

**Note:** The requirement to include the city and state is new and is not required under existing SSARS No. 19. The city and state where the accountant practices may be indicated on letterhead that contains the issuing office’s city and state.

- i. the date of the review report, which should be dated no earlier than the date on which the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework including evidence that:
  - all the statements that the financial statements comprise, including the related notes, have been prepared, and
  - management has asserted that they have taken responsibility for those financial statements.

**Note:** Because the accountant’s conclusion is provided on the financial statements, and the financial statements are the responsibility of management, the accountant is not in a position to conclude that the accountant has obtained limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, until evidence is obtained that all the statements that the financial statements comprise, including the related notes, have been prepared, and management has accepted responsibility for them. Management accepts responsibility for the financial statements by signing the representation letter.

5. If the financial statements include a separate statement of changes in stockholders’ equity accounts or a separate statement of comprehensive income, SSARS No. 21 requires that such statements be separately identified in the introductory paragraph of the report.
6. The accountant’s review report is normally addressed to those for whom the report is prepared. The report may be addressed to:



- the entity whose financial statements are being reviewed, or
- those charged with governance.

**Note:** A report on financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an accountant may be retained to review the financial statements of an entity that is not a client; in such a case, the report may be addressed to the entity and not to those charged with governance of the entity whose financial statements are being reviewed.

7. When the accountant is aware that the reviewed financial statements will be included in a document that contains other information, such as an annual report, the accountant may consider, if the form of presentation allows, identifying the page numbers on which the reviewed financial statements are presented. This helps users identify the financial statements to which the accountant's review report relates.

#### **Accountant's Review Report on Financial Statements Prepared in Accordance With a Special purpose framework**

1. The accountant should modify the review report when the accountant becomes aware that the financial statements do not include:
  - a. a description of the special purpose framework
  - b. a summary of significant accounting policies
  - c. an adequate description about how the special purpose framework differs from GAAP. The effects of these differences need not be quantified, and
  - d. informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.
2. In the case of financial statements prepared in accordance with a contractual basis of accounting, the accountant should modify the review report if the financial statements do not adequately describe any significant interpretations of the contract on which the financial statements are based.
3. The accountant's review report on financial statements prepared in accordance with a special purpose framework should:
  - when management has a choice of financial reporting frameworks in the preparation of such financial statements, make reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.
  - when the financial statements are prepared in accordance with a regulatory or contractual basis of accounting, describe the purpose for which the financial statements are prepared or refer to a note in the financial statements that contains that information.
4. The accountant's review report on financial statements prepared in accordance with a special purpose framework should include an emphasis-of-matter paragraph, under an appropriate heading, that:
  - indicates that the financial statements are prepared in accordance with the applicable special purpose framework
  - refers to the note to the financial statements that describes the framework, and
  - states that the special purpose framework is a basis of accounting other than GAAP.
5. The accountant's review report on special purpose financial statements should include an *other-matter* paragraph, under an appropriate heading, that restricts the use of the accountant's review report when the special purpose financial statements are prepared in accordance with:
  - a. a contractual basis of accounting,

- b. a regulatory basis of accounting, or
- c. an other basis of accounting where:
  - measurement or disclosure criteria are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria, or
  - measurement or disclosure criteria that are available only to the specified parties.

### **Comparative Financial Statements**

Comparative financial statements may be required by the applicable financial reporting framework, or management may elect to provide such information. When comparative financial statements are presented, the accountant's report should refer to each period for which financial statements are presented.

### **Updating the Report**

1. When reporting on all periods presented, a continuing accountant should update the report on one or more prior periods presented on a comparative basis with those of the current period. The accountant's report on comparative financial statements should not be dated earlier than the date that the accountant completed procedures sufficient to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework with respect to the current period.
2. When issuing an updated report, the continuing accountant should consider information that the accountant has become aware of during the review of the current period financial statements.
3. If, during the current engagement, circumstances or events come to the accountant's attention that may affect the prior-period financial statements presented, the accountant should consider the effects on the review report.

### **Changed Reference to a Departure From the Applicable Financial Reporting Framework**

- When the accountant's report on the financial statements of the prior period contains a changed reference to a departure from the applicable financial reporting framework, the accountant's review report should include an other-matter paragraph indicating:
  - the date of the accountant's previous review report
- the circumstances or events that caused the reference to be changed, and
- when applicable, that the financial statements of the prior period have been changed.

### **Reporting When One Period is Audited**

When the prior period financial statements were audited and the auditor's report on the prior period financial statements is not reissued, the review report on the current period financial statements should include an other-matter paragraph indicating:

- that the financial statements of the prior period were previously audited
- the date of the auditor's report on the prior period financial statements
- the type of opinion issued on the prior period financial statements
- if the opinion was modified, the substantive reasons for the modification, and
- that no auditing procedures were performed after the date of the previous report.

**Illustration 1—An Accountant’s Review Report on Comparative Financial Statements Prepared in Accordance With U.S. GAAP When a Review Has Been Performed for Both Periods**

Circumstances include the following:

- Review of a complete set of comparative financial statements
- The financial statements are prepared in accordance with U.S. GAAP

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5, and the related statements of income, changes in stockholders’ equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (owners’) financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

**Accountant’s Conclusion**

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

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s review report]*

**Illustration 2—An Accountant’s Review Report on a Single Year Financial Statements Prepared in Accordance With U.S. GAAP**

Circumstances include the following:

- Review of a complete set of financial statements (single year)
- The financial statements are prepared in accordance with U.S. GAAP

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders’ equity, and cash flows for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (owners’) financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

**Accountant’s Conclusion**

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

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s review report]*

**Illustration 3—An Accountant’s Review Report on Single Year Financial Statements Prepared in Accordance With the Tax Basis of Accounting**

Circumstances include the following:

- Review of a complete set of financial statements (single year)
- The financial statements are of a partnership and are prepared in accordance with the basis of accounting the partnership uses for income tax purposes (that is, tax basis financial statements)
- Management has a choice of financial reporting frameworks

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying financial statements of XYZ Partnership, which comprise the balance sheet—tax basis as of December 31, 20XX, and the related statements of income-tax basis, and partners’ capital-tax basis, for the year then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (partners’) financial data and making inquiries of partnership management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statement as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (partners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with the basis of accounting the Partnership uses for income tax purposes; this includes determining that the basis of accounting the Partnership uses for income tax purposes is an acceptable basis for the preparation of financial statements in the circumstances.<sup>9</sup> Management (partners) is (are) also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with the basis of accounting the Partnership uses for income tax purposes. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

**Accountant’s Conclusion**

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the Partnership uses for income tax purposes.

<sup>9</sup> When management has a choice of financial reporting frameworks, AR-C 90 requires that the review report make reference to management’s responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.

**Basis of Accounting**<sup>10</sup>

I (We) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the basis of accounting the Partnership uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion is not modified with respect to this matter.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant's city and state]*

*[Date of the accountant's review report]*

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<sup>10</sup> When a special purpose framework report is issued, the review report must include an emphasis-of-matter paragraph labeled “*Basis of Accounting*” or a similar title.

**Illustration 4—An Accountant’s Review Report on Interim Financial Statements Prepared in Accordance With U.S. GAAP**

Circumstances include the following:

- Review is performed on a complete set of financial statements for the period ended September 30, 20XX, and for the three and nine months then ended.
- The financial statements are prepared in accordance with U.S. GAAP.
- The accountant appropriately performs a review engagement in accordance with SSARS No. 21, AR-C 90 (that is, AU-C section 930, Interim Financial Information, is not applicable).

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheet as of September 30, 20XX, and the related statements of income, changes in stockholders’ equity, and cash flows for the three and nine months then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (owners’) financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting standards generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

**Accountant’s Conclusion**

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

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant’s city and state]*

*[Date of the accountant’s review report]*

**Illustration 5—An Accountant’s Review Report on Comparative Financial Statements Disclosing a Departure From U.S. GAAP**

Circumstances include the following:

- Review is performed on a complete set of comparative financial statements.
- The financial statements contain a departure from U.S. GAAP.

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X6 and 20X5, and the related statements of income, changes in stockholders’ equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (owners’) financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (owners) is (are) responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

**Accountant’s Conclusion**

Based on my (our) reviews, except for the issue noted in the Known Departure From Accounting Principles Generally Accepted in the United States of America paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

**Known Departure From Accounting Principles Generally Accepted in the United States of America**

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

or



As disclosed in note X to these financial statements, the company has adopted [description of newly adopted method], whereas it previously used [description of previous method]. Although the [description of newly adopted method] is in accordance with accounting principles as generally accepted in the United States, the company does not appear to have reasonable justification for making a change as required by Financial Accounting Standards Board Accounting Standards Codification 250, *Accounting Changes and Error Corrections*.

*[Signature of accounting firm or accountant, as appropriate]*

*[Accountant's city and state]*

*[Date of the accountant's review report]*

**Illustration 6—An Accountant’s Review Report on Comparative Consolidated Financial Statements in Which the Accountant Makes Reference to the Work of Other Accountants Who Were Engaged to Review the Financial Statements of a Significant Component**

Circumstances include the following:

- Review of a complete set of comparative consolidated financial statements.
- The financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X6 and 20X5, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended were reviewed by other accountants and the accountant has decided to make reference to the work of other accountant’s in the accountant’s review report.

**Independent Accountant’s Review Report**

*[Appropriate Addressee]*

I (We) have reviewed the accompanying consolidated financial statements of XYZ Company and its subsidiaries, which comprise the consolidated balance sheets as of December 31, 20X6 and 20X5, and the related consolidated statements of income, changes in stockholders’ equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management’s (owners’) financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

**Management’s Responsibility for the Financial Statements**

Management (owners) is (are) responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement whether due to fraud or error.

**Accountant’s Responsibility**

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. We have not reviewed the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets constituting 20 percent and 22 percent, respectively, of consolidated total assets at December 31, 20X6 and 20X5, and total revenues constituting 18 percent and 20 percent, respectively, of consolidated total revenues for the years then ended. These statements were reviewed by other accountants, whose report has been furnished to me (us), and our conclusion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other accountants.

SSARs require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

### Accountant's Conclusion

Based on my (our) reviews, and the report of other accountants, I am (we are) not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[Signature of accounting firm or accountant, as appropriate]

[Accountant's city and state]

[Date of the accountant's review report]

### Communicating to Management and Others Regarding Fraud or Noncompliance With Laws and Regulations

SSARS No. 21 carries over from auditing standards the concept of “*noncompliance with laws and regulations*,” a term that replaces the term “*illegal acts*.” The SSARS also provides guidance on addressing fraud in a review engagement.

1. If the accountant becomes aware that fraud (including misappropriation of assets) may have occurred, the accountant should communicate the matter as soon as practicable to the appropriate level of management (at a level above those involved with the suspected fraud, if possible).
2. If the accountant becomes aware of matters involving identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements, the accountant should communicate the matters to management, other than when matters are clearly inconsequential.
  - a. The communication of matters involving identified or suspected noncompliance may describe the act of identified or suspected noncompliance, the circumstances of its occurrence, and the effect on the financial statements. The accountant may reach agreement in advance with management and those charged with governance, if applicable, on the nature and amount of matters that would be considered not material and, thus, need not be communicated.
  - b. The disclosure of any evidence or information that comes to the accountant's attention during the performance of review procedures about fraud or noncompliance with laws or regulations to parties other than the entity's senior management (or those charged with governance, if applicable) ordinarily is not part of the accountant's responsibility and, ordinarily, would be precluded by the accountant's ethical or legal obligations of confidentiality.

A duty to disclose to parties outside of the entity may exist in the following circumstances, for which the accountant may consider it appropriate to consult with legal counsel:

    - To comply with certain legal and regulatory requirements
    - To a successor accountant when management has given permission for communication between the predecessor accountant and the successor accountant
    - In response to a subpoena
3. If the fraud or noncompliance with laws or regulations involves senior management or results in a material misstatement of the financial statements, the accountant should communicate the matter directly to those charged with governance.
4. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that:
  - a. the financial statements are not materially misstated due to fraud, or
  - b. the entity is in compliance with laws and regulations, and in the accountant's professional judgment, the effect of the suspected noncompliance may be material to the financial statements, the

accountant should consider the need to obtain legal advice and take appropriate action, including potential withdrawal.

5. The accountant may consider whether withdrawal from the engagement is necessary when:
  - a. management or those charged with governance do not take the remedial action that the accountant considers necessary in the circumstances or
  - b. matters regarding fraud or noncompliance with laws or regulations involve an owner of the business.

When deciding whether withdrawal from the engagement is necessary, the accountant may consider seeking legal advice.

### **Emphasis-of-Matter and Other-Matter Paragraphs in the Accountant’s Review Report**

SSARS No. 21 retains the emphasis-of-matter paragraph found in SSARS No. 19 and introduces the new “*other matter*” paragraph that is also available for use in new auditing standards.

#### **Emphasis-of-Matter Paragraphs in the Accountant’s Review Report**

1. If the accountant considers it necessary to draw users’ attention to a matter appropriately presented or disclosed in the financial statements that, in the accountant’s professional judgment, is of such importance that it is fundamental to users’ understanding of the financial statements, the accountant should include an emphasis-of-matter paragraph in the accountant’s review report, provided that the accountant does not believe that the financial statements may be materially misstated.

Such a paragraph should refer only to information presented or disclosed in the financial statements.

2. When the accountant includes an emphasis-of-matter paragraph in the accountant’s review report, the accountant should:
  - a. include it immediately after the accountant’s conclusion paragraph in the accountant’s review report,
  - b. use the heading “*Emphasis of Matter*” or other appropriate heading that describes the nature of the matter being disclosed or communicated:  
*Emphasis of Matter* or  
*Significant Transactions With Related Parties*
  - c. include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements, and
  - d. indicate that the accountant’s conclusion is not modified with respect to the matter emphasized.
3. Examples of circumstances when the accountant may consider it necessary to include an emphasis-of-matter paragraph include the following:
  - Uncertainty regarding an entity's ability to continue as a going concern for a reasonable period of time
  - Uncertainty relating to the future outcome of unusually important litigation or regulatory action
  - A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position
  - Significant transactions with related parties, and
  - Unusually important subsequent events.

#### **Other-Matter Paragraph in the Accountant’s Review Report**

If the accountant considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the accountant’s professional judgment, is relevant to the users’ understanding of the review, the accountant’s responsibilities, or the accountant’s review report,

the accountant should do so in a paragraph in the accountant’s review report with the heading “*Other Matter*” or other appropriate heading.

The accountant should include this paragraph immediately after the accountant’s conclusion paragraph and any emphasis-of-matter paragraph.

The ordering of presentation of an emphasis-of-matter and other-matter paragraphs follows:

- First:** Accountant's Conclusion Paragraph
- Then:** Emphasis-of-Matter Paragraph
- Then:** Other-Matter Paragraph

**Communication With Management**

If the accountant expects to include an emphasis-of-matter or other-matter paragraph in the accountant’s review report, the accountant should communicate with management regarding this expectation and the proposed wording of this paragraph.

In addition to management, the accountant may also consider it appropriate to communicate with those charged with governance regarding the expectation of including an other-matter paragraph in the accountant’s review report and the proposed wording of this paragraph.

The following chart summarizes when an emphasis-of-matter and other-matter paragraph may be required in accordance with a review engagement. This list is in addition to other situations in which emphasis-of-matter paragraph may be used.

<b>Situations In Which Emphasis-of-Matter or Other-Matter Paragraph are Used in Review Engagement</b>			
Description	AR-C 90 Paragraph	Emphasis-of-Matter Paragraph	Other-Matter Paragraph
<b>Emphasis-of-Matter Paragraph May Be Considered Necessary</b>			
Uncertainty regarding an entity's ability to continue as a going concern for a reasonable period of time	N/A	X	
Uncertainty relating to the future outcome of unusually important litigation or regulatory action	N/A	X	
A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position	N/A	X	
Significant transactions with related parties	N/A	X	
Unusually important subsequent events	N/A	X	
<b>Emphasis-of-Matter Or Other-Matter Paragraph Required</b>			
Restricted use paragraph in a report on special purpose financial statements prepared on a contractual-basis, regulatory-basis, or certain other-bases of accounting.	44		X
Restricted use paragraph in a report for any reason	61		X
Paragraph in a report of the prior period that contains a changed reference to a departure from the applicable financial reporting framework when reporting on comparative financial statements	49		X
Paragraph in a report on comparative financial statements when the prior period is audited	50		X
Paragraph with respect to reporting a known departure from the applicable financial reporting framework that is material to the financial statements	57	X	

<b>Situations In Which Emphasis-of-Matter or Other-Matter Paragraph are Used in Review Engagement</b>			
Description	AR-C 90 Paragraph	Emphasis-of-Matter Paragraph	Other-Matter Paragraph
Paragraph in a report when management revises financial statements for a subsequently discovered fact that became known to the accountant after the report release date and the accountant’s review report on the revised financial statements differs from the accountant’s review report on the original financial statements	75(c)	X	
Paragraph with respect to supplementary information that accompanies reviewed financial statements	80		X
Paragraph with respect to required supplementary information that accompanies reviewed financial statements	83		X

**Known Departures From the Applicable Financial Reporting Framework**

1. When the accountant becomes aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements, if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.
2. If the accountant concludes that modification of the standard report is adequate, the departure should be disclosed in a separate paragraph of the report under the heading “*Known Departures From the [identity the applicable financial reporting framework],*” including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known to the accountant as the result of the accountant’s procedures.

***Known Departure From Accounting Principles Generally Accepted in the United States of America***

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

3. If the effects of the departure have not been determined by management or are not known to the accountant as a result of the accountant’s procedures, the accountant is not required to determine the effects of a departure; however, in such circumstances the accountant should state in the report that such determination has not been made.
4. If the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant should withdraw from the review engagement.
5. The accountant should not modify the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework.
6. Examples of headings that an accountant may use to disclose departures from an applicable financial reporting framework in the accountant’s review report include the following:

- *Known Departures From Accounting Principles Generally Accepted in the United States of America*
- *Known Departures From International Financial Reporting Standards as Promulgated by the International Accounting Standards Board*
- *Known Departures From the Cash Basis of Accounting*
- *Known Departures From the Tax Basis of Accounting*

7. Prior to withdrawing from a review engagement in those circumstances when the accountant believes that modification of the standard report is not adequate to indicate the deficiencies in the financial statements as a whole, the accountant may wish to consult with legal counsel.
8. SSARS No. 21 states that an accountant is precluded from issuing a review report that states that the financial statements are not in accordance with the applicable financial reporting framework.

**Note:** Stating that the reviewed financial statements are not in accordance with the applicable financial reporting framework is not appropriate as it is tantamount to expressing an adverse opinion on the financial statements. Such an opinion can be expressed only in the context of an audit engagement and, if issued in the context of a review report, may confuse users. In essence, such a statement would contradict the statement about whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework.

9. Depending on the accountant's assessment of the possible dollar magnitude of the effect of the departures, the significance of the affected items to the entity, the pervasiveness and overall impact of the misstatements, and whether disclosure has been made of the effect of the departures, the accountant may include a separate paragraph in the accountant's review report stating the limitations of the financial statements.

The following is an illustration of such a separate paragraph with respect to an accountant's review report on financial statements prepared in accordance with accounting principles generally accepted in the United States of America:

***Limitations of the financial statements***

*Because the significance and pervasiveness of the matters described in the Known Departures From Accounting Principles Generally Accepted in the United States of America paragraphs makes it difficult to assess their impact on the financial statements, users of the accompanying financial statements should recognize that they might reach different conclusions about the company's financial position, results of operations, and cash flows if they had access to revised financial statements prepared in accordance with accounting principles generally accepted in the United States of America.*

**Restricting the Use of the Accountant's Review Report**

An accountant's review report should include an alert, in a separate other-matter paragraph, that restricts its use when the subject matter of the accountant's review report is based on:

- measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria, or
- measurement or disclosure criteria that are available only to the specified parties.

The alert that restricts the use of the accountant's review report should:

- state that the accountant's review report is intended solely for the information and use of the specified parties

- identify the specified parties for whom use is intended, and
- state that the accountant’s review report is not intended to be and should not be used by anyone other than the specified parties.

### **Adding Other Specified Parties**

When the accountant includes an alert that restricts the use of the accountant’s review report to certain specified parties and the accountant is requested to add other parties as specified parties, the accountant should determine whether to agree to add the other parties as specified parties.

If the other parties are added after the release of the accountant’s review report, the accountant should take one of the following actions:

- Amend the accountant’s review report to add the other parties. In such circumstances, the accountant should not change the original date of the accountant’s review report.
- Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties. The accountant should state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant’s review report.

When the accountant is requested to add other parties as specified parties, the accountant may agree to add other parties as specified parties based on the accountant’s consideration of factors such as the identity of the other parties and the intended use of the accountant’s review report.

### **Is an accountant permitted to restrict the use of any review report?**

Nothing in SSARs precludes an accountant from including a restricted-use paragraph in any accountant’s review report.

For example, financial statements prepared specifically for use in an acquisition, may be prepared in accordance with a general purpose framework because the parties involved in the transaction have agreed that such general purpose financial statements are appropriate for their purposes.

Nevertheless, when the terms of the engagement to review those financial statements require the accountant to supply the accountant’s review report only to specified parties, the accountant may consider it necessary in the circumstances to include an other-matter paragraph in the accountant’s review report that restricts the use of the accountant’s review report. Additionally, there is nothing within the standards that precludes an accountant from restricting the use of any report as long as the client agrees to it within the engagement letter.

### **Illustrative Alert Language**

The alert that restricts the use of the accountant’s review report may list the specified parties or refer to the specified parties listed elsewhere in the accountant’s review report. The following illustrates language that includes the elements required by SSARS No. 21.

#### ***Restricted Use***

*This report is intended solely for the information and use of [list or refer to the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.*

### **Distribution of the Accountant’s Review Report**

SSARS No. 21 states that an accountant is not responsible for controlling distribution of the accountant’s review report after its release. Restricted-use language in an accountant’s review report is used to avoid misunderstandings related to the use of the accountant’s review report, particularly if the accountant’s review report is taken out of the context in which the accountant’s review report is intended to be used. An accountant may consider informing the entity or other specified parties that the accountant’s review report is not intended for distribution to parties other than those specified in the accountant’s review report. The accountant may, in connection with establishing the terms of the engagement, reach an under-



standing with the entity that the intended use of the accountant’s review report will be restricted and may obtain the entity’s agreement that the entity and specified parties will not distribute such accountant’s review report to parties other than those identified.

**The Accountant’s Consideration of an Entity’s Ability to Continue as a Going Concern  
Consideration of Conditions or Events That Indicate That There Could be an Uncertainty About the Entity’s Ability to Continue as a Going Concern**

The accountant should consider whether, during the performance of review procedures, evidence or information came to the accountant’s attention indicating that there could be an uncertainty about an entity’s ability to continue as going concern for a reasonable period of time:

SSARS No. 21 defines a reasonable period of time as a period:

*“not to exceed one year beyond the date of the financial statements being reviewed”*

The date of the financial statements being reviewed is the report date and not the balance sheet date.

**Example:** Sally Fields is reviewing the financial statements for Company X for December 31, 2015 year end. Sally’s review report is dated March 25, 2016.

**Conclusion:** For purposes of evaluating going concern, Sally has to consider X’s ability to continue as a going concern for the period through March 25, 2017, which is one year from the report date.

If, after considering the evidence or information, the accountant believes that there is an uncertainty about the entity’s ability to continue as a going concern for a reasonable period of time, the accountant should request that management consider the possible effects of the going concern uncertainty on the financial statements, including the need for related disclosure.

After management communicates to the accountant the results of its consideration of the possible effects on the financial statements, the accountant should consider the reasonableness of management’s conclusions, including the adequacy of the related disclosure.

If the accountant determines that the entity’s disclosures with respect to the entity’s ability to continue as a going concern for a reasonable period of time are inadequate, a departure from the applicable financial reporting framework exists and the accountant should follow the guidance for known departures from the applicable financial reporting framework.

**Observation: SSARS No. 21 evaluates going concern in a review engagement using a one-year period from the date on which the financial statements have been “reviewed.”** The date on which the financial statements have been “reviewed” is the date on the review report which is also the same date on which the financial statements are issued or available to be issued.

With respect to GAAP, in August 2014, the FASB issued ASU 2014-15, *Presentation of Financial Statements—Going Concern (Subtopic 205-40), Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern*. ASU 2014-15 requires management to perform a self-assessment of an entity’s going concern. The ASU uses a one-year window that begins on the date on which the financial statements are available to be issued or issued.

It appears that the one-year window for an accountant to assess going concern in a review engagement and the one-year window used in management’s assessment of going concern in GAAP under ASU 2014-15, are aligned.

As for audits, existing auditing standards found in AU-C 570, *Going Concern*, provide a one-year going-concern assessment window that begins with the balance sheet date and ends one year later. The one-year window used by an auditor to assess going concern is not co-terminus with the one used by an

accountant in a review engagement under SSARS No. 21, or by management in performing its own self-assessment under ASU 2014-15.

The AICPA's Auditing Standards Board (ASB) is working on amending existing AU-C 570 to change the one-year auditor assessment period for going concern to one that is the same as ASU 2014-15. After that change, the one-year going-concern assessment period should be the same for review engagements, audit engagements and management self-assessments under GAAP. Until the ASB makes a change in the auditor's going-concern assessment window, the periods used to assess going concern by an audit will differ from the period used by an accountant in a review engagement or by management in its own assessment under GAAP.

## **Subsequent Events and Subsequently Discovered Facts**

### **Subsequent Events**

When evidence or information that subsequent events which require adjustment of, or disclosure in, the financial statements comes to the accountant's attention, the accountant should request that management consider whether each such event is appropriately reflected in the financial statements in accordance with the applicable financial reporting framework.

If the accountant determines that the subsequent event is not adequately accounted for in the financial statements or disclosed in the notes, the accountant should follow the guidance for known departures found in AR-C 90.

### **Subsequently Discovered Facts That Become Known to the Accountant Before the Report Release Date**

The accountant is not required to perform any review procedures regarding the financial statements after the date of the accountant's review report. However, if a subsequently discovered fact becomes known to the accountant before the report release date, the accountant should discuss the matter with management and, when appropriate, those charged with governance, and determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

1. If management revises the financial statements, the accountant should perform the review procedures necessary in the circumstances on the revision. The accountant also should either:
  - a. date the accountant's review report as of a later date, or
  - b. include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision of the financial statements described in the relevant note to the financial statements.
2. If management does not revise the financial statements in circumstances when the accountant believes they need to be revised, the accountant should modify the accountant's review report, as appropriate.

### **Subsequently Discovered Facts That Become Known to the Accountant After the Report Release Date**

1. If a subsequently discovered fact becomes known to the accountant after the report release date, the accountant should:
  - a. discuss the matter with management and, when appropriate, those charged with governance, and
  - b. determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.
2. If management revises the financial statements, the accountant should:
  - a. perform the review procedures necessary in the circumstances on the revision. The accountant also should either:

- date the accountant’s review report as of a later date, or
  - include an additional date in the accountant’s review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant’s review report for that revision), thereby indicating that the accountant’s review procedures subsequent to the original date of the accountant’s review report are limited solely to the revision of the financial statements described in the relevant note to the financial statements.
- b. if the reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph (3) below.
- c. if the accountant’s conclusion on the revised financial statements differs from accountant’s conclusion on the original financial statements, disclose in an emphasis-of-matter paragraph:
- the date of the accountant’s previous report,
  - a description of the revisions, and
  - the substantive reasons for the revisions.

**Note:** SSARS No. 21 states that new information may come to the accountant’s attention that, had such information been known to the accountant at the date of the accountant’s review report, may have caused the accountant to revise the accountant’s review report. When such information becomes known to the accountant after the report release date, the requirements noted in the previous paragraphs apply, even if the accountant has withdrawn or been discharged.

Because of the variety of conditions that might be encountered, the specific procedures or actions to be taken in a particular case may vary somewhat in light of the circumstances. For example, in determining whether the financial statements need revision, the accountant may consider, in addition to the requirements of the applicable financial reporting framework, whether the accountant believes persons are currently using or likely to use the financial statements who would attach importance to the subsequently discovered facts. Consideration may be given, among other things, to the issuance of reviewed or audited financial statements for a subsequent period, the time elapsed since the financial statements were issued and the date of the accountant’s review report released, and any legal implications.

The steps taken by management to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used, depend on the circumstances. Management’s steps may include the following:

- Notify anyone who is known to be using or who is likely to use the financial statements and the accountant’s review report that they are not to be used and that revised financial statements, together with a new accountant’s review report, will be issued. This may be necessary when the issuance of revised financial statements and a new accountant’s review report is not imminent.
- Issue, as soon as practicable, revised financial statements with appropriate disclosure of the matter.
- Issue the subsequent period’s financial statements with appropriate disclosure of the matter. This may be appropriate when issuance of the subsequent period’s reviewed or audited financial statements is imminent.

If management does not revise the financial statements in circumstances when the accountant believes they need to be revised, then:

- if the reviewed financial statements have not been made available to third parties, the accountant should notify management and those charged with governance, unless all of those charged with governance are involved in managing the entity, not to make the reviewed financial statements available to third parties before the necessary revisions have been made

and a new accountant's review report on the revised financial statements has been provided. If the reviewed financial statements are, nevertheless, subsequently made available to third parties without the necessary revisions, the accountant should apply the requirements of paragraph (b) below.

- if the reviewed financial statements have been made available to third parties, the accountant should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used. If management does not take the necessary steps, the accountant should apply the requirements of paragraph 3 below.
3. If management does not take the necessary steps to ensure that anyone in receipt of the financial statements is informed of the situation, the accountant should notify management and those charged with governance, unless all of those charged with governance are involved in managing the entity, that the accountant will seek to prevent future use of the accountant's review report. If, despite such notification, management or those charged with governance do not take the necessary steps, the accountant should take appropriate action to seek to prevent use of the accountant's review report.

### **Reference to the Work of Other Accountants in an Accountant's Review Report**

If other accountants audited or reviewed the financial statements of significant components, such as consolidated and unconsolidated subsidiaries and investees, and the accountant of the reporting entity decides not to assume responsibility for the audit or review performed by the other accountants, the accountant of the reporting entity should make reference to the review or audit of such other accountants in the accountant's review report. In that instance, the accountant should clearly indicate in the accountant's review report that the accountant used the work of other accountants and should include the magnitude of the portion of the financial statements audited or reviewed by the other accountants.

1. The accountant of the reporting entity may make reference to any, or all, other accountants who audited or reviewed significant components. For example, if a significant component is audited or reviewed by an other accountant and a second significant component is audited or reviewed by a different other accountant, the accountant of the reporting entity may decide to make reference to one of the other accountants, both of the other accountants, or neither. The decision is solely at the discretion and judgment of the accountant of the reporting entity.
2. The disclosure of the magnitude of the portion of the financial statements audited or reviewed by other accountants may be achieved by stating the dollar amounts or percentages of total assets, total revenues, other appropriate criteria, or a combination of these, whichever most clearly describes the portion of the financial statements audited or reviewed by other accountants. When two or more other accountants participate in the audit or review, the dollar amounts or the percentages covered by the other accountants may be stated in the aggregate.
3. Whether or not the accountant of the reporting entity decides to make reference to the review or audit of other accountants, the accountant of the reporting entity should communicate with the other accountants and ascertain:
  - a. that the other accountants are aware that the financial statements of the component which the other accountants have audited or reviewed are to be included in the financial statements on which the accountant of the reporting entity will report and that the other accountants' report thereon will be relied upon (and, where applicable, referred to) by the accountant of the reporting entity.
  - b. that the other accountants are familiar with the applicable financial reporting framework and with SSARSs or auditing standards generally accepted in the United States of America, as applicable and have conducted or will conduct the review or audit in accordance with the framework.

- c. that a review will be made of matters affecting elimination of intercompany transactions and accounts and, if appropriate in the circumstances, the uniformity of accounting practices among the components included in the financial statements.

**Supplementary Information That Accompanies Reviewed Financial Statements**

SSARS No. 21 clarifies the general reporting requirements and options pertaining to supplementary information that accompanies reviewed financial statements. Previously, the authority has been found in AR 90-60 as part of SSARS No. 19.

AR-C 90 clarifies the issue of as to how an accountant may report on supplementary information that accompanies reviewed financial statements.

In essence, if an accountant issues a review report on financial statements, he or she may report on supplementary information at any one of three levels:

- Review the supplementary information
- Compile the supplementary information, or
- Disclaim the supplementary information (no opinion)

The following chart summarizes the options for reporting on supplementary information for both compilation and review engagements:

<b>Reporting Options—Supplementary Information</b>	<b>Compilation Engagement</b>	<b>Review Engagement</b>
Review the supplementary information	No	Yes
Compile the supplementary information	Yes	Yes
Disclaim responsibility for the supplementary information: (Do not compile, review or audit the supplementary information)	Yes	Yes

When supplementary information accompanies reviewed financial statements and the accountant’s review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either:

- an other-matter paragraph in the accountant’s review report on the financial statements, or
- a separate report on the supplementary information.

**Reviewed or compiled supplementary information:**

1. When the accountant has reviewed both the financial statements and the supplementary information, an other-matter paragraph in the accountant’s review report on the financial statements or the separate report on the supplementary information should state that:
  - a. the information is presented for purposes of additional analysis and is not a required part of the financial statements
  - b. the information is the representation of management
  - c. the accountant has reviewed the information, and, based on the accountant’s review, whether the accountant is aware of any material modifications that should be made to the information in order for it to be in accordance with the applicable financial reporting framework, and
  - d. the accountant has not audited the information and, accordingly, does not express an opinion on such information.

The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the accountant has reviewed both the financial statements and the supplementary information:

**Supplementary information reviewed:**

***Other Matter***

The schedule of operating expenses [*or other identified supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have reviewed the information and, based on my (our) review, I am (we are) not aware of any material modifications that should be made to the information in order for it to be in accordance with [*the applicable financial reporting framework*]. I (We) have not audited the information and, accordingly, do not express an opinion on such information.

2. Following is a sample of an other-matter paragraph when the supplementary information is compiled while the financial statements have been reviewed.

**Supplementary information compiled:**

***Other Matter***

The schedule of operating expenses [*or other identified supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have compiled the information and, it has not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements. I (We) have not audited or reviewed the information and, accordingly, do not express an opinion on such information.

3. To minimize the possibility that a user of the information may infer, through the accountant's association with the information, an unintended level of reliance on the information, the accountant may consider including a reference to the accountant's review report on each page of the information.

An example of a reference to the accountant's review report included on each page of the supplementary information is:

*"See Independent Accountant's Review Report."*

**Disclaimer on supplementary information**

When the accountant has reviewed the financial statements but not the supplementary information, the other-matter paragraph in the accountant's review report on the financial statements or the separate report on the supplementary information should state that:

- the information is presented for purposes of additional analysis and is not a required part of the financial statements
- the information is the representation of management, and
- the accountant has not audited or reviewed the information and, accordingly, does not express an opinion, a conclusion, or provide any assurance on such information.

The following is an example of how an accountant may word an other-matter paragraph addressing supplementary information when the accountant has reviewed the financial statements but has not reviewed the supplementary information:

**Disclaimer on supplementary information:**

***Other Matter***

The schedule of operating expenses [*or other identified supplementary information*] is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information is the representation of management. I (We) have not audited, reviewed [*or compiled*] such information and, accordingly, I (we) do not express an opinion, a conclusion, or provide any assurance on it.

**Note:** In the sample other-matter paragraph found in paragraph A130 of AR-C 90, the language states that “we have not audited or reviewed such information.” There is no mention about not compiling the information. The author believes that the insertion of “compiled” is appropriate and has included it in brackets above.

**Required Supplementary Information**

Paragraph 80 of AR-C 90 states that with respect to required supplementary information, the accountant should include an other-matter paragraph in the accountant’s review report on the financial statements.

1. The other-matter paragraph should include language to explain the following circumstances, as applicable:
  - a. The required supplementary information is included, and the accountant performed a compilation engagement on the required supplementary information.
  - b. The required supplementary information is included, and the accountant reviewed the required supplementary information.
  - c. The required supplementary information is included, and the accountant did not perform a compilation, review, or audit on the required supplementary information.
  - d. The required supplementary information is omitted.
  - e. Some required supplementary information is missing, and some is presented in accordance with the prescribed guidelines.
  - f. The accountant has identified departures from the prescribed guidelines.
  - g. The accountant has unresolved doubts about whether the required supplementary information is presented in accordance with prescribed guidelines.
  
2. If the entity has presented all or some of the required supplementary information and the accountant did not compile or review the required supplementary information, the other-matter paragraph should include the following elements:
  - a. A statement that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require that the [*identify the required supplementary information*] be presented to supplement the basic financial statements.
  - b. A statement that such information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.
  - c. A statement that the accountant did not perform a compilation, review, or audit the required supplementary information and, accordingly, does not express an opinion or provide any assurance on the information.
  - d. If some of the required supplementary information is omitted:
    - a statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements
    - a statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who consid-

- ers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context
- e. If the measurement or presentation of the required supplementary information departs materially from the prescribed guidelines, a statement that material departures from prescribed guidelines exist [*describe the material departures from the applicable financial reporting framework*].
  - f. If the accountant has unresolved doubts about whether the required supplementary information is measured or presented in accordance with prescribed guidelines, a statement that the accountant has doubts about whether material modifications should be made to the required supplementary information for it to be presented in accordance with guidelines established by [*identify designated accounting standards setter*].
3. If all of the required supplementary information is omitted, the other paragraph should include the following elements:
    - a. A statement that management has omitted [*description of the missing required supplementary information*] that [*identify the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] require to be presented to supplement the basic financial statements.
    - b. A statement that such missing information, although not a part of the basic financial statements, is required by [*identify designated accounting standards setter*], who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context.
  4. Examples of required supplementary information that may accompany reviewed financial statements include the following:
    - With respect to common interest realty associations, estimates of current or future costs of major repairs and replacements of common property that will be required in the future as required by FASB ASC 972-235-50-3, *Real Estate—Common Interest Realty Associations*.
    - Management’s discussion and analysis and budgetary comparison statements as required by GASB No. 34, *Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments*.

### **Change in Engagement From Audit to Review**

If the accountant, who was engaged to perform an audit engagement in accordance with generally accepted auditing standards, has been requested to change the engagement to a review engagement, the accountant should follow rules found in AR-C 90.

1. The accountant should consider the following before deciding whether to agree to the change:
  - a. The reason given for the request, particularly the implications of a restriction on the scope of the audit engagement, whether imposed by management or by circumstances
  - b. The additional audit effort required to complete the audit engagement, and
  - c. The estimated additional cost to complete the audit engagement.
2. In all circumstances, if the audit procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement.
3. If the accountant concludes, based upon the accountant’s professional judgment, that reasonable justification exists to change the engagement, and if the accountant complies with the standards applicable to a review engagement, the accountant should issue an appropriate review report.
4. The report should not include reference to:
  - a. the original engagement
  - b. any audit procedures that may have been performed, or



- c. scope limitations that resulted in the changed engagement.
5. When the accountant has been engaged to audit an entity's financial statements and management refuses to allow the accountant to correspond with the entity's legal counsel, the accountant, except in rare circumstances, is precluded from accepting an engagement to review those financial statements.

**Note:** A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit engagement; a misunderstanding regarding the nature of an audit or review engagement, or a restriction on the scope of the audit engagement, whether imposed by management or caused by circumstances.

A change in circumstances that affects the entity's requirement for an audit engagement or a misunderstanding concerning the nature of an audit or review engagement would ordinarily be considered a reasonable basis for requesting a change in the engagement. The implications of a restriction on the scope of the audit engagement include the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory.

## Review Documentation

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AR-C 90 provides the following documentation requirements with respect to a review engagement:

1. The accountant should prepare review documentation that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand:
  - a. the nature, timing, and extent of the review procedures performed to comply with SSARSS
  - b. the results of the review procedures performed and the review evidence obtained, and
  - c. significant findings or issues arising during the review, the conclusions reached, and significant professional judgments made in reaching those conclusions.
2. The review documentation should include the following:
  - a. The engagement letter or other suitable form of written documentation with management,
  - b. Communications to management and others regarding fraud or noncompliance with laws and regulations
  - c. Communications with management regarding the accountant's expectation to include an emphasis-of-matter or other-matter paragraph in the accountant's review report
  - d. Communications with other accountants who have audited or reviewed the financial statements of significant components
  - e. The representation letter
  - f. A copy of the reviewed financial statements and the accountant's review report
3. Review documentation may be recorded on paper or electronic or other media.
4. The accountant need not include in review documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

**Note:** AR-C 90 states that an accountant is not prevented from supporting the review report by other means in addition to the review documentation, such as written documentation contained in other engagement files or quality control files, and, in limited situations, oral explanations. By themselves, oral explanations by the accountant do not represent adequate support for the work the accountant performed or conclusions reached, but they may be used to explain or clarify information contained in the review documentation.

## Review Questions

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1. Which of the following is not information on which an accountant may perform a review engagement under AR-C 90?
  - A. Balance sheet
  - B. Prospective information
  - C. Schedule of rental income
  - D. Schedule of accounts receivable
  
2. A key element of an other-matter paragraph is that:
  - A. It involves a communication of a matter that is presented in the financial statements, but not the notes
  - B. It involves a communication of a matter that is not presented in the financial statements, but is presented in the notes
  - C. It involves a communication of a matter that is presented or disclosed in the financial statements or the notes
  - D. It involves a communication of a matter that is not presented or disclosed in the financial statements or the notes
  
3. Which of the following is correct with respect to independence in a review engagement versus a compilation engagement?
  - A. Accountant must be independent in both a compilation and review engagement
  - B. Accountant must be independent in a review engagement but not in a compilation engagement
  - C. Accountant is not required to be independent in either a compilation or a review engagement
  - D. Accountant is not required to be independent in a review but is required to be independent in a compilation engagement
  
4. One requirement made by AR-C 90 is that in a review engagement, the accountant should communicate with management about what?
  - A. Deficiencies in internal control
  - B. Matters of significant importance
  - C. Calculations of analytical procedures
  - D. Matters that are restricted by law or regulation
  
5. John is an accountant performing a review engagement. John has a limited knowledge of the client's industry. Which of the following is correct?
  - A. John cannot perform the engagement because he has no knowledge of the industry
  - B. John may perform the engagement only after he receives extensive training for the industry
  - C. John may perform the engagement only if he brings on a co-reviewer who has extensive industry experience
  - D. John is not precluded from accepting the review engagement
  
6. Alice is an accountant performing a review engagement. She decides to confirm a bank loan directly with the bank. Which of the following is correct?
  - A. By performing an audit procedure (confirmation), Alice must step up her engagement to an audit
  - B. Alice is not required to perform an audit engagement
  - C. Alice must continue with her audit procedures and then convert the engagement to an audit
  - D. Alice is prevented from sending the confirmation if she wants to retain the review engagement

7. Which of the following is a new requirement that AR-C 90 adds for a review engagement?
  - A. Accountant should perform analytical procedures
  - B. Accountant should make inquiries of management and others
  - C. Accountant should obtain evidence that the financial statements agree with the accounting records
  - D. Accountant should obtain a management representation letter
  
8. AR-C 90 provides guidance as to what is deemed a material misstatement. It states that misstatements are material if, individually or in the aggregate \_\_\_\_\_.
  - A. The misstatements equal or exceed 10 percent of a benchmark such as gross sales, total assets, etc.
  - B. The misstatements would influence management's decisions as to how to manage the company
  - C. The misstatements could reasonably be expected to influence the economic decisions of users
  - D. The misstatements would influence the decisions of the largest or most significant user of the financial statements regardless of whether they would influence the decisions of all users taken as a whole
  
9. With respect to a management representation letter in a review engagement, which of the following is correct?
  - A. The written representations are dated as of the date of the review report
  - B. Review report cannot be dated after the date of the written representations
  - C. Review report must be dated before the date of the written representations
  - D. There is no correlation between the review report date and the date of the written representations
  
10. Al Hitchcock is performing a review engagement on Company X. Which of the following is correct?
  - A. Al must include a legend on each page of the financial statements such as “*See Independent Accountant's Review Report*”
  - B. Al may consider including a legend on each page of the financial statements such as “*See Independent Accountant's Review Report*”
  - C. Al is no longer permitted to include a legend on the pages of the financial statements as AR-C 90 restricts its use
  - D. If Al includes a legend, it must be placed at the top, rather than the bottom, of each page of the financial statements
  
11. Which of the following is not an appropriate paragraph heading in a review report?
  - A. Accountant's Responsibility
  - B. Opinion
  - C. Management's Responsibility for the Financial Statements
  - D. Accountant's Conclusion
  
12. In AR-C 90, the term “illegal acts” is replaced by what term?
  - A. Fraudulent activities
  - B. Unconventional transactions
  - C. Unethical actions
  - D. Noncompliance with laws and regulations

13. Which of the following is an example of a circumstance in which an auditor may consider it necessary to include an other-matter paragraph in his or her report?
- A. Significant transactions with related parties
  - B. With respect to supplementary information that accompanies reviewed financial statements
  - C. Uncertainty regarding an entity's ability to continue as a going concern
  - D. Unusually important subsequent events
14. Al Jenkins is performing a review engagement on Company X. There is uncertainty about X's ability to continue as a going concern for a reasonable period of time not to exceed \_\_\_\_\_.
- A. One year from the balance sheet date
  - B. One year beyond the date of the financial statements being reviewed
  - C. Two years from the balance sheet date
  - D. One year from the date on which the financial statements are available to be issued
15. Angie Jones is issuing a review report on financial statements. A schedule of cost of goods sold is accompanying the financial statements. Which of the following is not a permitted reporting option for Angie with respect to the schedule of cost of goods sold?
- A. Angie may review the schedule as supplementary information
  - B. Angie may audit the schedule as supplementary information
  - C. Angie may compile the schedule as supplementary information
  - D. Angie may disclaim the schedule

## Review Answers

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1.
  - A. Incorrect. AR-C 90 provides that a review engagement may be performed on financial statement such as a balance sheet. Thus the answer is incorrect.
  - B. **Correct.** The review standards found in AR-C 90 do not apply to prospective information. The primary reason is because it is difficult to provide negative assurance on prospective information.
  - C. Incorrect. AR-C 90 states that the review standards apply to a specified element, such as a schedule of rental income. Thus, the answer is incorrect.
  - D. Incorrect. AR-C 90 states that the review standards apply to a specified account, such as a schedule of accounts receivable. Thus, the answer is incorrect.
  
2.
  - A. Incorrect. An other-matter paragraph does not involve a communication of a matter that is presented in the financial statements, but not the notes. The matter is not presented elsewhere within the financial statements or notes.
  - B. Incorrect. An other-matter paragraph does not involve a communication of a matter that is not presented in the financial statements, but is presented in the notes. It involves a matter that is not presented in the notes.
  - C. Incorrect. An other-matter paragraph does not involve a communication of a matter that is presented or disclosed in the financial statements or the notes. In fact, if the matter is presented in the notes or financial statements, it would be an emphasis-of-matter paragraph and not an other-matter paragraph.
  - D. **Correct.** An important distinction is that an other-matter paragraph involves a communication of a matter that is not presented or disclosed elsewhere in the financial statements or the notes. Contrary to an emphasis-of-matter paragraph which requires the subject matter to be disclosed in the notes or elsewhere within the financial statements.
  
3.
  - A. Incorrect. An accountant is not required to be independent in a compilation engagement because he or she may disclaim the lack of independence in a compilation report. Thus, the answer is incorrect.
  - B. **Correct.** An accountant must be independent in a review engagement but not in a compilation engagement. In a compilation engagement, an accountant does have the option to disclaim independence which is not available in a review engagement.
  - C. Incorrect. An accountant is required to be independent in a review engagement making the answer incorrect.
  - D. Incorrect. An accountant is not required to be independent in a compilation engagement but is required to be independent in a review engagement. Thus, the answer is incorrect.
  
4.
  - A. Incorrect. Deficiencies in internal control, although important, are generally the focus of an audit engagement, not a review engagement.
  - B. **Correct.** AR-C 90 requires that an accountant communicate on a timely basis all matters from the review engagement that are of significant importance to merit the attention of management and those charged with governance.
  - C. Incorrect. Although calculations of analytical procedures are an important part of a review engagement, they are not identified as a typical matter that is communicated making the answer incorrect.
  - D. Incorrect. In general, an accountant may be restricted by law or regulation to communicate certain matters that are specifically prohibited. Thus, the answer is incorrect.
  
5.
  - A. Incorrect. AR-C 90 permits John to perform the engagement as long as he obtains the required level of knowledge of the industry.
  - B. Incorrect. John must obtain a level of knowledge but nothing in AR-C 90 requires that he obtain extensive training to obtain that level of knowledge.

- C. Incorrect. Nothing in AR-C 90 requires John to bring on a co-reviewer who has extensive industry experience. Thus, the answer is incorrect.
- D. **Correct.** AR-C 90 specifically states that there is nothing that prevents John from accepting the review engagement as long as he obtains the required level of knowledge.
6. A. Incorrect. AR-C 90 states that if an audit procedure is performed, Alice is not required to step up her engagement to an audit. Thus, the answer is incorrect.
- B. **Correct.** AR-C 90 states that an accountant may perform audit procedures and the engagement remains a review. Thus, the answer is correct.
- C. Incorrect. Alice is not required to perform any audit procedures, making the answer incorrect.
- D. Incorrect. Nothing in AR-C 90 prevents Alice from sending the confirmation even if she is performing a review engagement. Thus, the answer is incorrect.
7. A. Incorrect. The requirement that an accountant perform analytical procedures is not a new requirement in a review engagement making the answer incorrect.
- B. Incorrect. Making inquiries of management and others is not a new review procedure. It currently exists in SSARS No. 19.
- C. **Correct.** SSARS No. 21, AR-C 90 adds a new requirement that an accountant should obtain evidence that the financial statements agree or reconcile with the accounting records, such as the general ledger. This action was implicit under previous standards and now is explicitly required.
- D. Incorrect. Existing standards require an accountant to obtain a management representation letter so that this requirement is not new under AR-C 90.
8. A. Incorrect. Although rule of thumb approaches based on a percentage of some base are used in practice, the definition of materiality is not codified based on a fixed quantitative percentage, making the answer incorrect.
- B. Incorrect. Materiality is based on how a transaction(s) influences the end users and not management, making the answer incorrect.
- C. **Correct.** Materiality is measured based on how it affects end users and whether the misstatements could reasonably be expected to influence the economic decisions of those users.
- D. Incorrect. AR-C 90 states that materiality is determined based on consideration of the common financial information needs of users as a group, with the possible effect on specific individual users not considered. Thus, the answer is not correct.
9. A. **Correct.** In general, the written representations should be dated as of the date of the accountant's review report, which is the date on which all review procedures are completed. Obtaining a signed representation letter is part of review evidence needed to complete review procedures.
- B. Incorrect. The review report can be dated after the date of the written representations although optimally, they should be the same date. The signed management representation letter must be received and in hand prior to releasing the accountant's report so that the review report date can be after the date of the representations.
- C. Incorrect. The review report cannot be dated before the date of the representations because the representations must be received from management as part of review evidence needed to issue the report.
- D. Incorrect. There is a correlation between the two dates. The review report date must be the same as the date of management's representations or later. Thus, the answer is incorrect.
10. A. Incorrect. AR-C 90 removed the requirement to include such a legend that has been required up to now under SSARS No. 19. Thus, the answer is incorrect.
- B. **Correct.** AR-C 90 now permits, but no longer requires the legend to be included on each page of the financial statements. Thus, it is correct that AI may consider including a legend on each page of the financial statements such as "*See Independent Accountant's Review Report.*"

- C. Incorrect. AR-C 90 does, in fact, permit the inclusion of a legend on the pages of the financial statements. Thus, the answer is incorrect.
- D. Incorrect. AR-C 90 provides no restriction or requirement as to where any legend must be placed on each page of the financial statements. Thus, the answer is incorrect.
11. A. Incorrect. AR-C 90 provides that one of the paragraphs in the review report should have the heading “*Accountant's Responsibility*” and should describe the accountant's responsibility in conducting the review engagement.
- B. **Correct.** A paragraph labeled with an “*Opinion*” heading is not authorized by AR-C 90 and, instead, is a paragraph in the audit report. In a review report, because there is negative assurance given by the accountant, the heading “*opinion*” is inappropriate because an opinion is not given by the accountant.
- C. Incorrect. AR-C 90 provides that one of the paragraphs in the review report is “*Management's Responsibility for the Financial Statements*” within which the responsibilities of management are identified.
- D. Incorrect. The “*Accountant's Conclusion*” paragraph is the final paragraph in a review report in which the accountant offers negative assurance on the financial statements.
12. A. Incorrect. Although fraud is considered in a review engagement, the term “fraudulent activities” is not the successor of illegal activities, making the answer incorrect.
- B. Incorrect. AR-C 90 does not use the term “unconventional transactions” to reflect any type of transactions, making the answer incorrect.
- C. Incorrect. The term “unethical actions” is not used as a successor to illegal acts making the answer incorrect.
- D. **Correct.** AR-C 90 carries over from auditing standards the new term “noncompliance with laws and regulations” which supersedes the term “illegal acts.” Under the rules, an accountant is required to communicate suspected noncompliance with laws and regulations to management, unless such matters are clearly inconsequential.
13. A. Incorrect. An emphasis-of-matter paragraph is used, instead of an other-matter paragraph, when there are significant transactions with related parties. The reason is because the transaction is also disclosed in the notes to financial statements.
- B. **Correct.** Paragraph 80 of AR-C 90 states that an other-matter paragraph should be included in the accountant's review report when there is supplementary information that accompanies reviewed financial statements.
- C. Incorrect. When there is an uncertainty regarding an entity's ability to continue as a going concern, AR-C 90 requires that an emphasis-of-matter paragraph be used instead of an other-matter paragraph. The prime reason is because the uncertainty would also be disclosed in the notes. An emphasis-of-matter is used when a matter is disclosed in both the report and the notes to financial statements.
- D. Incorrect. AR-C 90 states that an emphasis-of-matter paragraph, not an other-matter paragraph, must be used when there is an unusually important subsequent event.
14. A. Incorrect. AR-C 90 does not use the balance sheet date to measure the one-year period. Existing auditing standards use it but not AR-C 90.
- B. **Correct.** AR-C 90 provides that a reasonable period of time is a period not to exceed one year beyond the date of the financial statements being reviewed. In general, the date the financial statements are “reviewed” is the report date.
- C. Incorrect. The period is one year, not two years, and the balance sheet date is not the beginning date. Thus, the answer is incorrect.
- D. Incorrect. Although the one year period is correct, it is not measured from the date on which the financial statements are available to be issued. Thus, the answer is incorrect.

15. A. Incorrect. AR-C 80 states that an accountant who reviews financial statements is permitted to review the supplementary information. Thus, the answer is incorrect.
- B. **Correct.** If the financial statements are reviewed, the supplementary information may not be audited because to do so would mean the level of service performed on the supplementary information would exceed the level provided on the underlying financial statements.
- C. Incorrect. AR-C 80 permits the accountant to compile the schedule as supplementary information even though the underlying financial statements are reviewed. In doing so, the accountant must include an other-matter paragraph in the review report addressing the compilation of the supplementary information.
- D. Incorrect. AR-C 80 permits the accountant to disclaim the schedule as supplementary information in which case the accountant states that he or she has not reviewed or compiled the supplementary information and takes no responsibility for it. Thus, the answer is incorrect.



## Chapter 6

# Implementation of SSARS No. 21

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All of the standards within SSARS No. 21 are effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.

In implementing the new standards, the following rules should be followed:

1. If the report covers comparative years financial statements, the new reports should cover both years including the prior comparative year which was issued under the previous standards.

**Example:** John CPA implements SSARS No. 21 early for 2014 and issues a review report for both 2014 and 2013.

**Conclusion:** Even though the new standards are implemented for 2014, the new review report should cover both 2014 and 2013, a year prior to the implementation year.

2. In the comparative financial statements, the new legends, financial statement titles, and report titles should be applied to both comparative financial statements even though the prior year was issued under the previous standards.

**Example:** Mary CPA implements SSARS No. 21 for 2014 (early implementation) and issues prepared financial statements under AR-C 70 for 2014. 2013 financial statements are presented comparatively even though the new preparation standard is not applied until 2014.

**Conclusion:** Mary should present 2013 financial statements comparatively with 2014 and should apply all of the new conventions under the new SSARS No. 21 to both years such as the “no assurance” legend, financial statement titles, etc.

**For 2014, the accountant prepares financial statements under AR-C 70 with no compilation engagement performed. What if an accountant compiled financial statements for 2013 and implements the new SSARS No. 21 in 2014.**

Although 2013 was originally compiled, nothing prevents the accountant from presenting 2013 financial statements comparatively with 2014 in a preparation of financial statements engagement. If so, there is no requirement that the accountant reference that he or she previously compiled the 2013 financial statements.

**What if an accountant compiled financial statements for 2013 under the SSARS No. 19 standards and implements the new SSARS No. 21 standards for 2014 compilation engagement?**

The same conclusion would be reached if the 2013 financial statements were compiled under the SSARS No. 19 standards and then compiled for 2014 under new SSARS No. 21. All of the 2014 requirements would be presented comparatively for 2014 and 2013, such as the optional “*See Accountant's Compilation Report.*” The new compilation report would be issued referencing both 2014 and 2013. There is no need to reference the accountant's compilation report that was issued for 2013 under SSARS No. 19, nor is there any requirement to reissue the 2013 report.

## Review Questions

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1. All of the standards within SSARS No. 21 are effective for the preparation of financial statements for periods ending on or after what date?
  - A. December 31, 2014
  - B. January 1, 2015
  - C. December 15, 2015
  - D. December 31, 2015

## Review Answers

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1.
  - A. Incorrect. Although early implementation is permitted, the effective date for the preparation of financial statements under SSARS No. 21 is not December 31, 2014.
  - B. Incorrect. Although early implementation is permitted, the effective date for the preparation of financial statements under SSARS No. 21 is not January 1, 2015.
  - C. **Correct.** All of the standards within SSARS No. 21 are effective for the preparation of financial statements for periods ending on or after December 15, 2015. Early implementation is permitted.
  - D. Incorrect. The effective date for the preparation of financial statements under SSARS No. 21 is earlier than December 31, 2015.

# Glossary

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## A

**Analytical procedures:** Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

**Applicable financial reporting framework:** The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

## B

**Basic financial statements:** Financial statements excluding supplementary information and required supplementary information.

## D

**Designated accounting standard-setter:** A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to Rule 202, Compliance With Standards (AICPA, Professional Standards, ET sec. 202 par. .01), and Rule 203, Accounting Principles (AICPA, Professional Standards, ET sec. 203 par. .01), of the AICPA Code of Professional Conduct.

## E

**Emphasis-of-matter paragraph:** A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

**Error:** Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

**Experienced accountant:** An individual (whether internal or external to the firm) who has practical review experience, and a reasonable understanding of review processes, SSARs and applicable legal and regulatory requirements, the business environment in which the entity operates, and review and financial reporting issues relevant to the entity's industry.

## F

**Financial reporting framework:** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

**Fraud:** An intentional act that results in a misstatement in financial statements.

## M

**Management:** The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

**Misstatement:** A difference between the amount, classification, presentation, or disclosure of a reported financial item in the financial statements and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

## **N**

**Noncompliance:** Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. Noncompliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

## **O**

**Other-matter paragraph:** A paragraph included in the accountant's review report that is required by SSARs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's judgment, is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

## **R**

**Report release date:** The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

**Required supplementary information:** Information that a designated accounting standard-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of that information have been established.

**Review documentation:** The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as working papers or workpapers are also sometimes used).

**Review evidence:** Information used by the accountant to provide a reasonable basis for the obtaining of limited assurance.

## **S**

**Special purpose framework:** A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting: cash basis, tax basis, regulatory basis, contractual basis, or other basis that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in the financial statements.

**Specified parties:** The intended users of the accountant's review report.

**Subsequent events:** Events occurring between the date of the financial statements and the date of the accountant's review report.

**Subsequently discovered facts:** Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's review report.

**Supplementary information:** Financial information presented outside the financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework.

**T**

**Those charged with governance:** The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

**U**

**Updated report:** A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

**W**

**Written representation:** A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements or supporting books and records.

## Glossary

# Index

## A

Accountant not independent, 100  
Analytical procedures, 5, 123, 125, 127, 128, 129, 132, 135, 139, 142, 147, 148, 149, 152, 160, 164, 165, 166, 168, 169, 171, 183, 197  
AR Sections  
    Mapping, 2  
    Superseded by SSARS No. 21, 2  
AR-C Section 60, 2, 3, 6, 9  
AR-C Section 70, 2, 3, 6, 21  
    Applicable engagements, 22  
    Documentation, 36  
    Effective date, 21  
    Engagement letter, 36  
    Interim period, 26  
    Introduction, 21  
    Non-applicable engagements, 22  
    Scope, 21  
AR-C Section 80, 2, 4, 6, 72  
    Documentation, 119  
    Effective date, 73  
    Engagement letter, 78  
    General rules, 96  
    Introduction, 72  
    Key changes, 72  
    Limitations, 78  
    Objective, 74  
    Procedures, 93  
    Report, 94  
    Requirements, 76  
    Scope, 73  
AR-C Section 90, 2, 4, 6, 127  
    Documentation, 186  
    Effective date, 129  
    Engagement letter, 134  
    General principles, 132  
    Independence, 132  
    Introduction, 127  
    Objective, 129  
    Preconditions, 133  
    Requirements, 127, 132  
    Scope, 128  
ARSC's Clarity Project, 1  
Auditing Standards Board (ASB), 1, 179

## C

Cash basis, 27, 75, 131  
Change in engagement, 185  
Communication with management, 145  
Comparative financial statements, 129, 163  
Compilation engagements, 2, 6, 9, 10, 12, 14, 18, 21, 28, 32, 72, 73, 74, 76, 79, 82, 85, 88, 93, 119, 182  
Compilation procedures, 93  
Compilation report, 94  
Contractual basis, 27, 75, 131

## D

Disclaimer report, 26, 28, 31, 32, 35, 37, 39, 42, 43, 44, 52, 55, 56, 60, 64  
Disclosures, 4, 22, 28, 33, 34, 35, 36, 37, 39, 40, 42, 44, 45, 46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 61, 62, 63, 72, 73, 77, 82, 84, 85, 87, 89, 94, 96, 98, 100, 101, 107, 110, 114, 130, 133, 134, 136, 140, 141, 143, 145, 146, 151, 162, 173, 178  
Disclosures omitted, 22, 34, 36  
Documentation  
    AR-C Section 70, 36  
    AR-C Section 90, 186

## E

Effective date  
    AR-C Section 70, 21  
    AR-C Section 80, 73  
    AR-C Section 90, 129  
    SSARS 21, 1  
Emphasis-of-matter paragraph, 126, 129, 162, 167, 173, 174, 180, 197  
Engagement letter  
    AR-C Section 70, 36  
    AR-C Section 80, 78  
    AR-C Section 90, 134  
Engagement partner, 10  
Engagement team, 10  
Ethical requirements, 13

## F

Financial reporting framework, 3, 10, 12, 14, 18, 26, 27, 28, 29, 31, 32, 34, 35, 37, 38, 74, 75, 76, 77, 78, 80, 83, 86, 89, 91, 93, 94, 98, 101, 102, 104, 105, 113, 114, 129, 130, 131, 132, 133, 134, 136, 139, 143, 147, 149, 151, 152, 154, 155, 161, 162, 163, 166, 174, 175, 176, 178, 179, 180, 181, 182, 183, 184, 185, 197  
Financial statements  
    Reading, 151  
    Reconciling, 151  
    Reporting on, 160  
Firm, 11

## G

General purpose framework, 12  
Going concern, 178

## H

Historical financial information, 130



## Index

### I

Independence, 77, 100, 132  
Inquiries of management, 149  
International Standard on Auditing (ISA), 5  
Interpretative publications, 11, 16

### K

Knowledge of the entity, 146  
Known departure, 176  
Known departures, 28, 34, 37, 55, 56, 94, 101, 104, 105, 137, 140, 144, 174, 175, 176, 178, 179, 184, 185

### M

Management, 197  
Management use only financial statements, 105  
Mapping of AR to AR-C, 2  
Materiality, 152  
Misstatement, 75, 130, 198  
Modified cash basis, 99  
Monitoring, 17

### N

Nonattest service, 3, 21, 23, 24, 25, 26, 28, 30, 77, 79, 81, 82, 84, 85, 88, 90, 91, 92, 135, 138, 141, 144, 158  
Noncompliance, 130, 172, 198

### O

Objective  
    AR-C Section 90, 129  
    SSARS No. 21, 1  
OCBOA statements, 27, 73, 75, 99, 131  
Other-matter paragraph, 131, 173, 174, 198

### P

Peer review, 29  
Personal financial statements, 55  
Preparation of financial statements, 2, 6, 9, 10, 12, 14, 18, 21, 22, 24, 28, 29, 36, 42, 45, 52  
Prescribed form financial statements, 5, 27, 55, 56, 75, 104, 105, 131, 184, 185  
Presumptively mandatory requirements, 16  
Professional judgment, 3, 10, 11, 13, 14, 15, 16, 22, 92, 129, 130, 145, 147, 148, 152, 172, 173, 185

### Q

Quality control, engagement level, 16

### R

Regulatory basis, 27, 75, 99, 131  
Report release date, 131, 198  
Responsibilities of management, 37, 78, 134  
Review documentation, 186  
Review engagements, 2, 9, 10, 11, 14, 21, 132, 133, 134, 135, 138, 142, 153, 174  
Review procedures, 147  
Review report  
    Distribution of, 177  
    Restricting the use of, 176

### S

Special purpose framework, 4, 6, 12, 27, 32, 33, 35, 46, 72, 74, 75, 77, 97, 98, 99, 100, 101, 114, 128, 130, 134, 141, 162, 167, 198  
Specified parties, 131, 198  
SSARS No. 21  
    Background, 1  
    Effective date, 1  
    General principles, 9  
    Implementation, 194  
    Key changes, 3  
    Objective, 1  
Subsequent events, 131, 179, 198  
Subsequently discovered facts, 131, 198  
Supplementary information, 5, 22, 28, 34, 35, 40, 49, 74, 75, 80, 81, 83, 84, 86, 87, 89, 90, 97, 102, 103, 104, 105, 110, 128, 131, 132, 137, 138, 140, 141, 143, 144, 175, 182, 183, 184, 185, 198, 199

### T

Tax basis, 27, 32, 33, 36, 45, 46, 50, 51, 56, 75, 88, 99, 114, 115, 116, 131, 138, 166, 176  
Third parties, 146  
Those charged with governance, 4, 26, 27, 30, 36, 37, 74, 75, 77, 78, 127, 129, 130, 132, 133, 134, 145, 146, 150, 153, 155, 156, 162, 172, 173, 174, 179, 180, 181, 199

### U

Unconditional requirements, 16  
Updated report, 132, 199

### W

Written representations, 132, 153, 199