Association with financial statements; Statement on auditing standards, 026

American Institute of Certified Public Accountants. Auditing Standards Board

Statement on Auditing Standards

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Issued by the Auditing Standards Board

AICPA American Institute of Certified Public Accountants

Association With Financial Statements

(Supersedes Statement on Auditing Standards No. 1, sections 516, 517, and 518 and Statement on Auditing Standards No. 15, paragraphs 13–15)[1]

1. The fourth standard of reporting is:

> The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

The objective of the fourth reporting standard is to prevent misinterpretation of the degree of responsibility the accountant assumes when his name is associated with financial statements.

2. This Statement defines *association* as that term is used in the fourth reporting standard. It provides guidance to an accountant associated with the financial statements of a public entity or with a nonpublic entity's financial statements that he has been engaged to

[1]This Statement amends SAS No. 2 by the addition of the following to footnote 10:

> If an accountant is engaged to conduct an examination of the financial statements of a nonpublic entity in accordance with generally accepted auditing standards, but is requested to change the engagement to a review or compilation of the statements, he should look to the guidance in Statement on Standards for Accounting and Review Services 1, paragraphs 44–49.

examine in accordance with generally accepted auditing standards.[2]

3. An accountant is associated with financial statements when he has consented to the use of his name in a report, document, or written communication containing the statements.[3] Also, when an accountant submits to his client or others financial statements that he has prepared or assisted in preparing, he is deemed to be associated even though the accountant does not append his name to the statements. Although the accountant may participate in the preparation of financial statements, the statements are representations of management, and the fairness of their presentation in conformity with generally accepted accounting principles is management's responsibility.

4. An accountant may be associated with audited or unaudited financial statements. Financial statements are audited if the accountant has applied auditing procedures sufficient to permit him to report on them as described in SAS No. 2, *Reports on Audited Financial Statements*. The unaudited interim financial statements (or financial information) of a public entity are reviewed when the accountant has applied procedures sufficient to permit him to report on them as described in SAS No. 24, *Review of Interim Financial Information.*

Disclaimer of Opinion on Unaudited Financial Statements

5. When an accountant is associated with the financial statements of a public entity, but has not audited or reviewed[4] such statements, the form of report to be issued is as follows:

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[2]For purposes of this Statement, a public entity is any entity (*a*) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (*b*) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (*c*) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (*a*) or (*b*). (This Statement amends SAS No. 24, footnote 1, by substituting the foregoing definition of a public entity.) Statements on Standards for Accounting and Review Services provide guidance in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity.

[3]However, this Statement does not apply to data, such as tax returns, prepared solely for submission to taxing authorities.

[4]When a public entity does not have its annual financial statements audited, an accountant may be requested to review its annual or interim financial statements. In those circumstances, an accountant may make a review and look to the guidance in

> The accompanying balance sheet of X Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.
>
> (Signature and date)

This disclaimer of opinion is the means by which the accountant complies with the fourth standard of reporting when associated with unaudited financial statements in these circumstances. The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited. When an accountant issues this form of disclaimer of opinion, he has no responsibility to apply any procedures beyond reading the financial statements for obvious material errors. Any procedures that may have been applied should not be described, except in the limited circumstances set forth in paragraphs 18–20. Describing procedures that may have been applied might cause the reader to believe the financial statements have been audited or reviewed.

6. If the accountant is aware that his name is to be included in a client-prepared written communication of a public entity containing financial statements that have not been audited or reviewed, he should request (*a*) that his name not be included in the communication or (*b*) that the financial statements be marked as unaudited and that there be a notation that he does not express an opinion on them. If the client does not comply, the accountant should advise the client that he has not consented to the use of his name and should consider what other actions might be appropriate.[5]

Disclaimer of Opinion on Unaudited Financial Statements Prepared on a Comprehensive Basis of Accounting

7. When an accountant is associated with unaudited financial statements of a public entity prepared in accordance with a compre-

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Statements on Standards for Accounting and Review Services for the standards and procedures and form of report applicable to such an engagement.

[5]In considering what actions, if any, may be appropriate in the circumstances, the accountant may wish to consult his legal counsel.

hensive basis of accounting other than generally accepted accounting principles, he should follow the guidance provided by paragraph 5, except that he should modify the identification of financial statements in his disclaimer of opinion (see SAS No. 14, *Special Reports*, paragraphs 2–8).[6] For example, a disclaimer of opinion on cash-basis statements might be worded as follows:

> The accompanying statement of assets and liabilities resulting from cash transactions of XYZ Corporation as of December 31, 19X1, and the related statement of revenues collected and expenses paid during the year then ended were not audited by us and, accordingly, we do not express an opinion on them.
>
> (Signature and date)

A note to the financial statements should describe how the basis of presentation differs from generally accepted accounting principles, but the monetary effect of such differences need not be stated.

Disclaimer of Opinion When Not Independent

8. The second general standard requires that "in all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors." The independent public accountant must be without bias with respect to the client; otherwise, he would lack that impartiality necessary for the dependability of his findings. Whether the accountant is independent is something he must decide as a matter of professional judgment.

9. When an accountant is not independent, any procedures he might perform would not be in accordance with generally accepted auditing standards, and he would be precluded from expressing an opinion on such statements. Accordingly, he should disclaim an opinion with respect to the financial statements and should state specifically that he is not independent.

10. If the financial statements are those of a nonpublic entity, the accountant should look to the guidance in Statements on Standards for Accounting and Review Services. In all other circumstances, re-

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[6]Reference to generally accepted accounting principles in this Statement includes, where applicable, another comprehensive basis of accounting.

gardless of the extent of procedures applied, the accountant should follow the guidance in paragraph 5, except that the disclaimer of opinion should be modified to state specifically that he is not independent. The reasons for lack of independence and any procedures he has performed should not be described; including such matters might confuse the reader concerning the importance of the impairment of independence. An example of such a report is as follows:

> We are not independent with respect to XYZ Company, and the accompanying balance sheet as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.
>
> (Signature and date)

Circumstances Requiring a Modified Disclaimer

11. If the accountant concludes on the basis of facts known to him that the unaudited financial statements on which he is disclaiming an opinion are not in conformity with generally accepted accounting principles, which include adequate disclosure, he should suggest appropriate revision; failing that, he should describe the departure in his disclaimer of opinion. This description should refer specifically to the nature of the departure and, if practicable, state the effects on the financial statements or include the necessary information for adequate disclosure.

12. When the effects of the departure on the financial statements are not reasonably determinable, the disclaimer of opinion should so state. When a departure from generally accepted accounting principles involves inadequate disclosure, it may not be practicable for the accountant to include the omitted disclosures in his report. For example, when management has elected to omit substantially all of the disclosures, the accountant should clearly indicate that in his report, but the accountant would not be expected to include such disclosures in his report.

13. If the client will not agree to revision of the financial statements or will not accept the accountant's disclaimer of opinion with the description of the departure from generally accepted accounting principles, the accountant should refuse to be associated

with the statements and, if necessary, withdraw from the engagement.

Reporting on Audited and Unaudited Financial Statements in Comparative Form

14. When unaudited financial statements are presented in comparative form with audited financial statements in documents filed with the Securities and Exchange Commission, such statements should be clearly marked as "unaudited" but should not be referred to in the auditor's report.

15. When unaudited financial statements are presented in comparative form with audited financial statements in any other document, the financial statements that have not been audited should be clearly marked to indicate their status and either (*a*) the report on the prior period should be reissued (see SAS No. 1, section 530.06–.08)[7] or (*b*) the report on the current period should include as a separate paragraph an appropriate description of the responsibility assumed for the financial statements of the prior period (see paragraphs 16 and 17). Either reissuance or reference in a separate paragraph is acceptable; in both circumstances, the accountant should consider the current form and manner of presentation of the financial statements of the prior period in light of the information of which he has become aware during his current engagement.

16. When the financial statements of the prior period have been audited and the report on the current period is to contain a separate paragraph, it should indicate (*a*) that the financial statements of the prior period were examined previously, (*b*) the date of the previous report, (*c*) the type of opinion expressed previously, (*d*) if the opinion was other than unqualified, the substantive reasons therefor, and (*e*) that no auditing procedures were performed after the date of the previous report. An example of such a separate paragraph is as follows:

> The financial statements for the year ended December 31, 19X1, were examined by us (other accountants) and we (they) expressed an

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[7]For reissuance of a compilation or review report, see Statements on Standards for Accounting and Review Services.

unqualified opinion on them in our (their) report dated March 1, 19X2, but we (they) have not performed any auditing procedures since that date.

17. When the financial statements of the prior period have not been audited and the report on the current period is to contain a separate paragraph, it should include (*a*) a statement of the service performed in the prior period, (*b*) the date of the report on that service, (*c*) a description of any material modifications noted in that report, and (*d*) a statement that the service was less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements taken as a whole. When the financial statements are those of a public entity, the separate paragraph should include a disclaimer of opinion (see paragraph 5) or a description of a review. When the financial statements are those of a nonpublic entity and the financial statements were compiled or reviewed, the separate paragraph should contain an appropriate description of the compilation or review. For example, a separate paragraph describing a review might be worded as follows:

> The 19X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in conformity with generally accepted accounting principles. However, a review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements taken as a whole.

A separate paragraph describing a compilation might be worded as follows:

> The 19X1 financial statements were compiled by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

Negative Assurance

18. When an accountant, for whatever reason, disclaims an opinion on financial statements his disclaimer should not be contradicted by the inclusion of expressions of assurance on the absence of knowledge of departures from generally accepted accounting principles except as specifically recognized as appropriate in applicable standards established by the American Institute of Certified Public Accountants.

19. Negative assurances, for example, are permissible in letters for underwriters in which the independent auditor reports on limited procedures followed with respect to unaudited financial statements or other financial data pertinent to a registration statement filed with the Securities and Exchange Commission (see SAS No. 1, section 630, "Letters for Underwriters").

20. An accountant may also be requested to describe limited procedures followed with respect to unaudited financial statements of a public entity, similar to those performed for a letter for underwriters, in connection with a proposed acquisition and give negative assurance regarding the financial statements taken as a whole. Acceptance and performance of such an engagement is appropriate if the applicable requirements for a letter for underwriters are met (see SAS No. 1, section 630). When an accountant is requested to report on the results of applying agreed-upon procedures to one or more specified elements, accounts, or items of a financial statement in connection with a proposed acquisition, he should report in accordance with SAS No. 14, *Special Reports*, paragraphs 15–17; as specified in SAS No. 14, the financial statements of the entity may not accompany this special report.

The Statement entitled "Association With Financial Statements" was adopted by the assenting votes of twelve members of the board, of whom one, Mr. Bedford, assented with qualification. Messrs. Gotlieb and Walker dissented.

Messrs. Gotlieb and Walker dissent to the issuance of this Statement because in accordance with paragraph 5 the accountant has no responsibility to apply any procedures beyond reading the financial statements for obvious material errors. They believe this allows a lower level of service to be performed for a public entity than a nonpublic entity. Accordingly, Messrs. Gotlieb and Walker believe that the procedures required under SSARS 1 for a compilation service and the related compilation report are appropriate for public companies and would mitigate the proliferation of unaudited disclaimers that may confuse users.

Mr. Bedford approves issuance of this Statement but qualifies his assent because he believes the fundamental association of the accountant is with financial reports rather than financial statements alone. He believes generally accepted accounting principles, the needs of society, and the interests of business and the accounting profession require accounting identification and association with financial reports and that this SAS should not limit an accountant to association with financial statements nor impede association with required financial reports.

Auditing Standards Board (1978-1979)

Note: *Statements on Auditing Standards are issued by the Auditing Standards Board, the senior technical body of the Institute designated to issue pronouncements on auditing matters. Rule 202 of the Institute's Code of Professional Ethics requires adherence to the applicable generally accepted auditing standards promulgated by the Institute. It recognizes Statements on Auditing Standards as interpretations of generally accepted auditing standards and requires that members be prepared to justify departures from such Statements.*