Understanding and implementing SSARS no. 8; AICPA practice aid series;

J. Russell Madray
Leslye Givarz

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_guides

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
https://egrove.olemiss.edu/aicpa_guides/62

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Guides, Handbooks and Manuals by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.
Understanding and Implementing SSARS No. 8
Notice to Readers

This publication, *Understanding and Implementing SSARS No. 8*, is a Practice Aid intended to provide CPAs with the most recent information related to changes to Statements on Standards for Accounting and Review Services (SSARSs). The document has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA.
Understanding and Implementing SSARS No. 8

Written by
J. Russell Madray, CPA

Edited by
Leslye Givarz
Technical Manager
Accounting and Auditing Publications
Acknowledgments

The Accounting and Auditing Publications Team would like to thank the members of the Accounting and Review Services Committee and Kim Gibson, CPA, AICPA Technical Manager, for their suggestions about issues to cover in this Practice Aid. We also appreciate the fine job of the author, Russ Madray, in developing and writing this Practice Aid and the valuable reviews provided by Diane Conant, CPA, and Kim Gibson, CPA.
# Table of Contents

Introduction ................................................................................................................................................1
Overview of the Changes .........................................................................................................................1
Submission of Financial Statements ...................................................................................................... 2
Management-Use-Only Compilation .....................................................................................................5
  Third Parties ........................................................................................................................................6
  Form of Communication ..................................................................................................................... 8
Engagement Planning and Administration .............................................................................................9
  Choosing the Right Client .................................................................................................................. 9
  Choosing the Right Engagement ........................................................................................................ 11
  Independence Issues .......................................................................................................................... 13
  Communication Options ................................................................................................................... 13
Engagement Performance ..................................................................................................................... 20
  Performance Standards ...................................................................................................................... 20
  Communication Requirements ........................................................................................................... 21
  Documentation .................................................................................................................................. 21
  When to Withdraw From the Engagement ..................................................................................... 22
Form and Content of the Financial Statements ...................................................................................23
  Transmittal Letter ............................................................................................................................... 23
  Basis of Accounting and Financial Statement Titles ..................................................................... 23
  Legend on Each Page of the Financial Statements ........................................................................ 24
  Supplementary Information ............................................................................................................... 24
  Comparative Financial Statements ................................................................................................... 25
Other Implementation Issues ................................................................................................................. 26
  Correlation With Other Professional Services .............................................................................. 26
  Controllership Services ..................................................................................................................... 27
Scores

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Peer Review Implications</td>
<td>28</td>
</tr>
<tr>
<td>Effective Date</td>
<td>29</td>
</tr>
<tr>
<td>Implementation Survey Results</td>
<td>29</td>
</tr>
<tr>
<td>Implementation Questions and Answers</td>
<td>30</td>
</tr>
<tr>
<td>Appendix A: Client Acceptance Form</td>
<td>37</td>
</tr>
<tr>
<td>Appendix B: Client Information Form</td>
<td>39</td>
</tr>
<tr>
<td>Appendix C: Illustrative Engagement Letter—Management-Use-Only Compilation</td>
<td>44</td>
</tr>
<tr>
<td>Appendix D: Illustrative Engagement Letter—Traditional Compilation</td>
<td>46</td>
</tr>
<tr>
<td>Appendix E: Illustrative Engagement Letter—Bookkeeping Services</td>
<td>48</td>
</tr>
<tr>
<td>Appendix F: Management-Use-Only Compilation Engagement Checklist</td>
<td>50</td>
</tr>
<tr>
<td>Appendix G: Compilation of Financial Statements Flowchart</td>
<td>52</td>
</tr>
<tr>
<td>Appendix H: Text of Statement on Standards for Accounting and Review Services No. 8</td>
<td>55</td>
</tr>
</tbody>
</table>
Introduction

Understanding and Implementing SSARS No. 8 is a nonauthoritative Practice Aid designed to help CPAs implement Statement on Standards for Accounting and Review Services (SSARS) No. 8, Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100). This Practice Aid clarifies certain existing SSARSs, suggests ways of implementing existing and new standards in special circumstances, points out pitfalls that frequently occur in compilation engagements, and provides practical guidance to help implement the changes in SSARS No. 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100).

Note: Throughout this Practice Aid, we use the term “traditional compilation” to indicate an engagement that results in compiled financial statements with a compilation report and the term “management-use-only compilation” to indicate an engagement that results in compiled financial statements without a compilation report (as allowed by SSARS No. 8). These terms are not used in SSARS No. 8, but are used in this publication for clarity.

Overview of the Changes

One of the goals of SSARS No. 1, when it was issued in 1978, was to establish a minimum level of service for unaudited financial statements of nonpublic entities. To accomplish this, SSARS No. 1 contained a “trigger.” SSARS No. 1 (AR sec. 100.07) stated,

The accountant should not submit unaudited financial statements of a nonpublic entity to his or her client or others unless, as a minimum, he or she complies with the provisions of this statement applicable to a compilation engagement. Submission of financial statements is defined as presenting to a client or others financial statements that the accountant has (a) generated, either manually or through the use of computer software, or (b) modified, by materially changing account classification, amounts, or disclosures directly on client-prepared financial statements. [emphasis added]

Although initially this trigger was effective and served its purpose, in the years since SSARS No. 1 was issued several things changed, including the profession, the competitive environment, and technology. These changes progressively led to several problems for practitioners that can be summarized as problems related to the applicability of SSARS No. 1 and to market-driven influences.

As our profession changed and as our relationships with our clients changed, many practitioners felt constrained by the requirements in SSARS No. 1. For example, a client may have needed financial statements solely for management purposes. Yet SSARS No. 1 required the accountant
to perform a compilation engagement and issue a report on the financial statements, even if neither the client nor the accountant felt the need for compiled financial statements.

Then, issuance of SSARS No. 8 made the following major changes in SSARS No. 1:

- The definition of submission of financial statements changes to only include the “preparation and presentation of financial statements.”
- A provision for a special management-use-only compilation engagement is created (when the financial statements are not expected to be used by a third party).

Submission of Financial Statements

SSARS No. 1 is applicable whenever you submit unaudited financial statements of a nonpublic entity to your client or third parties. SSARS No. 8 modifies the definition of “submission.” Submission of financial statements is now defined as follows (AR sec. 100.04):

Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

Some in the profession will argue that this change in the definition of submission will create a loophole for those who want to avoid performing a compilation. However, the AICPA’s Accounting and Review Services Committee (ARSC) believes that this modification is the best way to address today’s technological environment, while still retaining the trigger, thereby ensuring a minimum level of service on financial statements that are prepared by the accountant and presented to the client.

Note that the following two actions on the part of the practitioner are necessary in order to submit financial statements:

- Prepare financial statements, either manually or through the use of computer software
- Present the financial statements to a client or third party

Absent either of these actions, the financial statements have not been submitted, and SSARS No. 1 is not applicable.

---

1 Statement on Standards for Accounting and Review Services No. 8, Amendment to Statement on Accounting and Review Services No. 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100), amends SSARS No. 1 by replacing former paragraphs 100.01-.22 with new paragraphs 100.01-.23 (renumbering subsequent paragraphs and footnotes accordingly), adding new Appendixes A and D, and deleting former Appendix E. SSARS No. 8 is not published in the Professional Standards as a standalone section. For the purposes of this Practice Aid, we are using the phrases “SSARS No. 1, as amended,” and “SSARS No. 1” to differentiate between passages that were amended by SSARS No. 8 and those which were not.
SSARS No. 8 does not define the term "prepared." Rather, you must use your professional judgment to determine if you are going to prepare a financial statement. In making this judgment, you should consider the difference between mere performing bookkeeping services (for example, making adjustments, corrections, and accruals) and preparation of financial statements.

The term "presenting" is also not defined in SSARS No. 8. Again, you will have to use your professional judgment to determine if you are going to present financial statements to a client. Obviously, physically presenting printed financial statements would meet the definition used here. Other situations, however, especially those involving electronic presentation (for example, via e-mail), warrant careful consideration.

**Practice Pointer.** There is no definitive line to cross that would indicate that you are submitting financial statements. Therefore, you should establish a firm policy to evaluate how certain accounting services are classified within your firm.

Table 1 provides you with helpful guidelines to consider using in determining if you have submitted financial statements. Note, however, that every situation will require you to use your judgment. These scenarios are based on the author’s opinion—you may reach different conclusions.

**Table 1 Determining If You Have Submitted Financial Statements**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Submission of Financial Statements?</th>
<th>Reasoning</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Using client information, the CPA prepares financial statements for use in preparing a corporate income tax return and the financial statements are not given to the client.</td>
<td>No.</td>
<td>The financial statements are not presented to the client, and the information contained in a tax return is not considered a financial statement.</td>
</tr>
<tr>
<td>2. Same scenario as 1, except that a copy of the financial statements are given to the client, along with the income tax return.</td>
<td>Yes.</td>
<td>The financial statements are prepared by the accountant and presented to the client.</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>Scenario</th>
<th>Submission of Financial Statements?</th>
<th>Reasoning</th>
</tr>
</thead>
<tbody>
<tr>
<td>3. Same scenario as 1, except that copies of the adjusting journal entries and trial balance are given to the client, along with the income tax return.</td>
<td>No.</td>
<td>A trial balance is not a financial statement.</td>
</tr>
<tr>
<td>4. The CPA makes material adjustments to the client’s accounting database that, based on the CPA’s professional judgment, constitutes preparing financial statements; prints the adjusted financial statements; and takes the financial statements with him or her.</td>
<td>No.</td>
<td>Although the accountant has prepared the financial statements, the accountant has not presented them to the client.*</td>
</tr>
<tr>
<td>5. Same scenario as 4, except that the CPA also prints copies of the financial statements and presents them to the client.</td>
<td>Yes.</td>
<td>The accountant is providing bookkeeping services (which, in the accountant’s judgment, constitute preparing financial statements) and has presented financial statements to the client.*</td>
</tr>
<tr>
<td>6. The client sends the CPA a disk containing information from the client’s accounting database. The CPA makes adjustments to the disk and returns it to the client.</td>
<td>No.</td>
<td>The accountant is providing bookkeeping services, but the accountant is not “preparing” financial statements. Material modifications no longer constitute a submission of financial statements.*</td>
</tr>
<tr>
<td>7. The CPA accesses the client’s accounting database by modem and makes material modifications (that, in the CPA’s judgment, do not constitute preparing financial statements) to the accounting database.</td>
<td>No.</td>
<td>The accountant is providing bookkeeping services, but the accountant is not “preparing” financial statements. Material modifications no longer constitute a submission of financial statements.*</td>
</tr>
</tbody>
</table>
8. The CPA accesses the client’s online accounting package (for example, E-Ledger™ or NetLedger™) and makes material modifications to the accounting database (that in the CPA’s judgment do not constitute preparing financial statements).

9. In scenarios 6, 7, or 8, the CPA, using his or her professional judgment, determines that the service provided to the client will result in preparation of financial statements for presentation to the client.

* Note that each scenario requires a certain amount of professional judgment. If you believe that, in making these material adjustments, you have, in fact, prepared financial statements and have gone beyond mere bookkeeping services, and, if you believe that you have presented them to the client or others, then you should comply with SSARS No. 1.

The issue of “submission” should be addressed early in engagement planning. This issue, along with the needs of the client and other financial statement users, is essential to determining the type of engagement you will perform. For further discussion of engagement selection, see the “Choosing the Right Engagement” section later in this Practice Aid.

**Management-Use-Only Compilation**

SSARS No. 8 states that financial statements may be submitted to a client without a report (for management-use-only financial statements) if the financial statements “are not reasonably expected to be used by a third party.” In order to understand this change in SSARS No. 1, you need to understand two important concepts—third parties and form of communication.
Third Parties

In deciding whether the financial statements are or reasonably might be expected to be used by a third party, you may rely on management’s representation without further inquiry, unless information comes to your attention that contradicts management’s representation.

SSARS No. 1, as amended (AR sec 100.04), defines third parties as follows:

All parties except for members of management who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.

Note that this is a definition by exception. In other words, the starting point for determining who is a third party is that all parties are third parties, with the exception of certain members of management. Those certain members of management would be those members who are knowledgeable enough about the business to be able to put the information in the proper context. ARSC chose not to define “third parties,” but instead to define who is not a third party. In order to not be considered a third party, the person or persons must meet two requirements:

1. He or she is a member of management
2. He or she is knowledgeable enough about the business to put the information in the proper context.

For guidance on determining whether or not a person is a member of management, you may refer to Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 57, Related Party Disclosures, which includes the following definition:

Persons who are responsible for achieving the objectives of the enterprise and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management normally includes members of the board of directors, the chief executive officer, chief operating officer, vice presidents in charge of principal business functions (such as sales, administration, or finance), and other persons who perform similar policymaking functions. Persons without formal titles also may be members of management.

In Exhibit 1, “Third Parties,” circle C represents all potential users of an entity’s financial statements (banks, bonding companies, creditors, shareholders, vendors, customers, and so on), and circle B represents all members of management. All users in circle C would be considered third parties. In addition, members of management in circle B—those without the requisite knowledge of the client’s business that would allow them to place the information contained in the financial statements in the proper context—also would be considered third parties. Compiled financial statements which do not include a report should be restricted to those parties in circle A—those members of management who have the requisite knowledge of the business.
Does this mean you will have to make judgments about management’s knowledge of their own business? Although some judgment will be involved in making this determination, you may rely on management’s representation to you that they have the necessary knowledge of the business to put the information in the proper context (see Appendix C, “Illustrative Engagement Letter—Management-Use-Only Compilation,” of this publication).

Does this definition mean that certain members of management must be thoroughly knowledgeable about technical accounting principles and procedures? No. Management must be knowledgeable about the nature of the services you are providing and understand the procedures and assumptions you are using. In other words, the users of these financial statements should understand both what you are doing and any limitations in the resulting financial statements. Consider these examples of third parties:

- ABC Company is a small, closely-held business, owned and managed by its sole shareholder, John. In this situation, absent evidence to the contrary, John has the requisite knowledge of his business and would not be considered a third party.

- KLM Company is a small, closely-held business, managed by one of its ten shareholders, Jane (the other nine shareholders live out of state and are not involved in the management of the business). In this situation, absent evidence to the contrary, Jane has the requisite knowledge of the business and would not be considered a third party. The other nine shareholders, however, would be considered third parties.
Understanding and Implementing SSARS No. 8

- XYZ Company is a small, closely-held business. The management team consists of a president, Joe; controller, Mary; operations manager, Sue; and sales manager, Jim. Joe, Mary, and Sue are all involved in the financial operation of the company and are knowledgeable about the accounting principles and practices being used. Jim, on the other hand, has no finance background and is not involved in the financial operation of the company. In this example, Joe, Mary, and Sue would not be considered third parties. Jim, although he is a member of management, does not have the requisite knowledge of the accounting practices of the business and would be considered a third party.

Note that those members of management who are considered third parties (Jim in the preceding example) could be “brought into the loop” or removed from third-party status. Removing management members from third-party status would occur by educating them about the accounting principles and practices of the business, thereby allowing them to place the information in the proper context. This education could be accomplished by other members of management or by the accountant.

Practice Pointer. Note that these financial statements are intended to be restricted to management use, not internal use. Internal use implies that anyone who is internal to the client might be the intended user of the financial statements (for example, all employees). SSARS No. 1, as amended, requires that these financial statements be restricted to non-third-party use.

Form of Communication

If you submit financial statements to a client that will be used by a third party (or if you reasonably expect that they might be used by a third party), you must comply with the reporting requirements in SSARS No. 1, as amended (AR sec. 100.11-.19).

If the financial statements are for management’s use only (and you do not reasonably expect them to be used by a third party), there is an additional communication option—a written engagement letter, preferably signed by management. The requirements for the written engagement letter are discussed in the “Management-Use-Only Compilation Engagement Letters” section later in this Practice Aid.

Some practitioners have suggested that there is no real difference between the traditional compilation and the management-use-only compilation since essentially the same information is communicated in either a compilation report or an engagement letter. Although there are similarities in the two forms of communication, there are substantial differences in these engagements. Both forms of communication (report and engagement letter) are used to communicate:
• **What the engagement is.** In both cases, the CPA tells the user that the financial statements are compiled and explains what a compilation is (presenting in the form of financial statements information that is the representation of management).

• **What the engagement is not.** In both cases, the CPA tells the user that the financial statements are not audited or reviewed and that no opinion or any other form of assurance is expressed.

• **Departures in the financial statements.** In both cases the CPA tells the user about any departures in the financial statements. In this area, however, the way in which departures are communicated is very different:
  
  — Traditional compilation (report). SSARS No. 1 (AR sec. 100.40-.41), states that if you become aware of a measurement or disclosure departure in the financial statements, the financial statements should be revised or the report should be modified to disclose the departure. In other words, absent revision of the financial statements, you should add an additional paragraph to the report to disclose the nature of the departure and the effect of the departure on the financial statements (if the effect is known).

  — Management-use-only compilation (engagement letter). SSARS No. 1, as amended (AR sec. 100.21), states, among other things, that the accountant should include in the engagement letter a statement that material departures from GAAP or OCBOA may exist and that the effects of those departures, if any, on the financial statements may not be disclosed.

The reason for this difference in the management-use-only compilation engagement letter is based on the intended user of the financial statements. In the case of a traditional compilation, the financial statements are intended to be used by anyone (general use). Therefore, the departures must be communicated in such a way as to be understood by anyone, including those not familiar with the financial matters of the entity. In the case of a management-use-only compilation, the financial statements are intended for a limited group of management ("non-third parties"). By definition, these members of management have a certain level of knowledge about the business and about the engagement that the accountant is performing. For that reason, you can handle the issue of departures in a more broad way, for example, "departures may exist," rather than specifically identifying each and every known departure.

**Engagement Planning and Administration**

**Choosing the Right Client**

Engagements to compile financial statements for management’s use only are not appropriate for every client due to the unique nature of these financial statements and the fact that they are restricted for management’s use only. Just as you make decisions every day about client and
engagement selection, you will also have to make decisions about when management-use-only compilations are appropriate.

Key issues to consider in determining whether or not to perform a management-use-only compilation engagement for a particular client include the following:

- **Information that might bear on the integrity of management.** Has information come to your attention that gives you reason to doubt the integrity of management? Since a requirement to perform a management-use-only compilation is to obtain representations from management about the intended use of the financial statements, you should carefully consider the implications of management representations.

- **Past experience with management.** Have past experiences on other engagements been positive?

- **Independence considerations.** You may have to consider carefully the independence implications of being closely involved with management-use-only financial statements.

As is the case with any type of engagement, it is essential that you know your client, as noted in the first bullet above. One of the requirements for a management-use-only compilation is that you obtain representations from the client that the financial statements will not be used by third parties. You must be able to rely on this representation in order to perform the management-use-only compilation. In order to make that judgment, you must know your client. Some of the following tips may be helpful when evaluating a potential client (although none of these procedures is required by professional standards):

- **Gain access to available financial information.** Review the prior year’s financials, with emphasis on leverage for debt. Look at the client’s assets and sources of income, as well as the current condition of accounting records.

- **Review S&P, Moodys, or other publications.** Many localities provide a local or regional “S&P” in conjunction with the Daily Journal of Commerce or similar business publication. There is a plethora of available information on the Web. In addition, many firms offer database searches of financial, legal, and operational information, as well as personal information about key executives. Check the court dockets (including the U.S. Bankruptcy and Tax Court dockets) in the area where the client is domiciled.

- **Meet with financial persons of the company.** Ask for a brief overview of their internal practices and procedures, the business plan, bylaws, staff turnover, and so on. Representatives from other departments may provide information as well.
• Discuss the prospective client with former accountants (after the client provides you with written authorization).

The “Client Acceptance Form” included in Appendix A of this Practice Aid may be useful as you evaluate potential clients.

Practice Pointer. Dun & Bradstreet offers an Internet search service at www.dandbsearch.com. Using this search service, you can get information on any public or privately-held business, including business background, credit reports, supplier evaluations, and more.

Choosing the Right Engagement

SSARS No. 1, as amended (AR sec. 100.04), defines a compilation as follows:

Presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements.

Note that this definition does not require you to test, verify, or corroborate information supplied by management, but, simply, to place the information into the form of financial statements.

SSARS No. 1, as amended, now provides for two types of compilations:

• A compilation with a report is required when you have been engaged to compile and report on the financial statements or when you reasonably expect that the financial statements may be used by a third party. This type of engagement might be referred to as a traditional compilation.

• A compilation without a report is available when you do not reasonably expect the financial statements to be used by a third party. This type of engagement might be referred to as a management-use-only compilation.

Note that, in either case, the engagement is a compilation requiring that you comply with the performance requirements of SSARS No. 1 (discussed later). The difference between the two options lies in the form of communication used in the engagement, as discussed in the earlier section of this Practice Aid, “Form of Communication.” Exhibit 2 illustrates the two kinds of compilation engagements.
Exhibit 2 Compilation Engagements

Do you reasonably expect a third party to use the compiled financial statements?

YES

Traditional Compilation
You must attach a compilation report in accordance with the guidance in SSARS No. 1, as amended (AR sec. 100.11-.19).

NO

Management-Use-Only Compilation
Two options are available:
• A compilation report in accordance with the guidance in SSARS No. 1, as amended (AR sec. 100.11-.19), OR
• An engagement letter, preferably signed by management, in accordance with the requirements of SSARS No. 1, as amended (AR sec. 100.21).

Several issues must be considered in determining the best type of engagement for a particular client, including:

• Needs of third parties. Does a third party (for example, a bank) need compiled financial statements on a regular basis? If so, it may be more practical to perform a traditional compilation engagement.

• Cost-benefit considerations. Can you perform the engagement at a reasonable cost to the client?

• Risk management considerations. Some practitioners may perceive the management-use-only compilation as more risky than a “traditional” compilation (which offers the additional protection of the compilation report). Others, however, see the specific representations and restrictions agreed to in the engagement letter of a management-use-only compilation as additional protections that are not present in a traditional compilation.

If the client does not need audited or reviewed financial statements, you can choose from these three types of engagements:
• A traditional compilation (required if third parties will use the financial statements)

• A management-use-only compilation (available if third parties will not use the financial statements)

• Bookkeeping services (available if the procedures do not include the submission of financial statements)

The decision about the best type of engagement for your client should be made early in engagement planning and should be based on a combination of (1) the needs of the client and other users, (2) your knowledge of the client, and (3) the nature of the procedures you will perform.

Independence Issues

SSARS No. 1 requires that you identify a lack of independence in a compilation engagement and prohibits you from reviewing financial statements if you are not independent. You would have to note the lack of independence either in the compilation report or in the engagement letter if the financial statements are restricted to management’s use and not intended for use by third parties. You would note the lack of independence by adding the following sentence to the appropriate communication:

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

Guidance for determining independence can be found in Rule 101, “Independence” (AICPA, Professional Standards, vol. 2, ET sec. 101), the interpretations of Rule 101, and the related independence rulings, of the AICPA Code of Professional Conduct. You should also consult the independence rules of your state board of accountancy, your state CPA society, and any applicable regulatory agency.

Independence is a difficult area—it is easy to define, but difficult to apply. Therefore, you might find the AICPA Plain English Guide to Independence on applying the independence rules helpful (download at www.aicpa.org/members/div/ethics/plaineng.htm).

Communication Options

As noted previously, if you submit financial statements to a client that will be used by a third party (or if you reasonably expect that they might be used by a third party), you must comply with the reporting requirements in SSARS No. 1, as amended (AR sec. 100.11-.19). If the financial statements are for management’s use only (and you do not reasonably expect them to be used by a third party), there is an additional communication option: a written engagement letter (preferably signed by management).

Note that if actions taken during the engagement subsequently impair your independence, you should update the engagement letter noting this fact.
Management-Use-Only Compilation Engagement Letters

The engagement letter in a management-use-only compilation must contain these elements:

- A description of the nature and limitations of the services to be provided.
- A statement that a compilation is limited to presenting in the form of financial statements information that is the representation of management.
- A statement that the financial statements will not be audited or reviewed.
- A statement that no opinion or any other form of assurance on the financial statements will be provided.
- An acknowledgment that management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.
- An acknowledgment of management’s representation and agreement that the financial statements will not be used by third parties.
- A statement that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts.

Practice Pointer. It is permissible to issue one engagement letter to cover multiple periods or multiple services. However, it is recommended that this engagement letter be updated at least annually and whenever there is a change in management. Annual updating helps accommodate the fact that client relationships change over time, and it is especially important in the management-use-only compilation engagement to ensure that there is a good understanding between the CPA and the client because of the restricted nature of and limitations in the financial statements.

The engagement letter should also include the following additional matters, if applicable:

- A statement that material departures from generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (OCBOA) may exist and the effects of those departures on the financial statements may not be disclosed.
- A statement that substantially all disclosures (and the statement of comprehensive income and statement of cash flows, if applicable) required by GAAP or OCBOA may be omitted.
- A statement that the accountant is not independent.
- A reference to any supplementary information that may be included.

An example of the engagement letter communication is in Appendix C of this Practice Aid.
As an option, you may choose to further limit the use of management-use-only financial statements to specified members of management. To accomplish this, you may add an optional paragraph to the engagement letter, as follows:

The financial statements are intended solely for the information and use of John Doe, Jane Doe, and Jim Smith, and are not intended to be and should not be used by any other party.

Management is not required to sign the engagement letter, but it is preferable and highly advisable to obtain management’s signature. This signature on the engagement letter helps to ensure that management has read and understands the letter and the engagement.

If the engagement letter is mailed to the client, it may be advisable to send the letter by certified mail or another means that would provide proof of receipt. In any case, include a copy of the engagement letter in your engagement documentation.

Practice Pointer. It is important to exercise care in adding additional services to the engagement letter. Although it is common to address additional services such as bookkeeping, tax, payroll, and consulting in the engagement letter, it is not advisable to include both the management-use-only compilation and traditional (unrestricted) compilation engagements in the same engagement letter. Should the client need compiled financial statements for third-party use, it is recommended that a separate engagement letter be issued in order to reduce the risk of misunderstanding and confusion about the two types of engagements.

Required Understanding for a Traditional Compilation

If the engagement is a traditional compilation, SSARS No. 1, as amended (AR sec. 100.05), requires that you establish an understanding with the client, preferably in writing. This understanding should include:

- A description of the nature and limitations of the services.
- A description of the report the accountant expects to render.
- A statement that the engagement cannot be relied upon to detect errors, fraud, or illegal acts.
- A statement that the accountant will inform the appropriate level of management of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential.

An example of an engagement letter for a traditional compilation is included in Appendix D of this Practice Aid.
Suggested Understanding for Non-SSARS Services

If your client does not need compiled financial statements (taking into account the needs of the client and other users), you may, instead, choose to perform only bookkeeping services.\(^3\) Other than the broad general ethical guidance available in the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 201), there are no authoritative standards for bookkeeping services; thus, it is wise to at least establish a written understanding with the client concerning these services. This understanding should include:

- A description of the nature and limitations of the services.
- A statement that the engagement cannot be relied upon to detect errors, fraud, or illegal acts.

**Practice Pointer.** Bookkeeping services fall under the guidance in Statements on Standards for Consulting Services (SSCSs). SSCS No. 1, *Consulting Services: Definitions and Standards* (AICPA, *Professional Standards*, vol. 2, CS sec. 100), states that you should have an “understanding with the client” for any consulting engagement that you undertake. This oral or written understanding should be reached with the client about the responsibilities of the parties and the nature, scope, and limitations of the engagement to be performed. If circumstances require a significant change during the engagement, the understanding should be modified.

Although not an authoritative requirement, a written engagement letter for a bookkeeping services engagement may be even more important than an engagement letter in SSARS engagements. Because you have no specific standards to follow for these engagements, the engagement letter is all that you have to rely on to define the bookkeeping engagement. Other professional engagements, such as audits, reviews, and compilations, include the added benefit of authoritative standards that define the engagement objectives, limitations, communication, and so on. Appendix E includes an example of an engagement letter for a bookkeeping service engagement.

**Communications Between Predecessor and Successor Accountants**

SSARS No. 4, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, AR sec. 400), establishes guidance for communication between predecessor and successor accountants. Unlike SAS No. 84, *Communications Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315), which requires such communication between predecessor and successor auditors, SSARS No. 4 does not require communication. However, SSARS No. 4 does state that communication may be desirable when:

---

\(^3\) See the discussion in the “Submission of Financial Statements” section earlier in this Practice Aid for guidance on determining whether your services should be viewed as bookkeeping services or as “preparing and presenting” financial statements, which necessitates following the guidance in SSARSs.
• Information about the prospective client is limited or requires special attention.

• The change in accountants occurs substantially after the end of the accounting period for which financial statements are to be compiled or reviewed.

• The client has frequently changed accountants.

The AICPA Code of Professional Conduct requires you to obtain the client’s permission if you decide to make inquiries of the predecessor, and the client should authorize the predecessor to respond fully. If the client will not permit communication, you should consider withdrawing from the engagement or not accepting the engagement.

There is one situation in which you are required to communicate with the predecessor. In the course of a review or compilation engagement, if you become aware of information that indicates that the prior-period financial statements require revision, you are required to request that the client communicate this information to the predecessor.

Engagement acceptance inquiries. If you decide to communicate with the predecessor, either orally or in writing, you might inquire about the following:

• Information that might bear on the honesty or integrity of management.

• Disagreements with management about accounting matters or performance of compilation or review procedures.

• Cooperation from management when additional or revised information is needed.

• Predecessor’s understanding about the reason for change in accountants.

Other inquiries. You may want to make additional inquiries such as:

• Inadequacies in the client’s underlying financial data

• The need to perform other accounting services

• Areas that have required inordinate time in prior periods

SSARS No. 4 does require the predecessor, when authorized by the client, to respond fully to your engagement acceptance inquiries (except in unusual circumstances, such as litigation). SSARS No. 4 does not require the predecessor to respond to inquiries that would simply facilitate your performance of the engagement.

SSARS No. 4 states that, if authorized by the client, the predecessor should ordinarily make available certain work papers relating to matters of continuing significance and those relating to contingencies. However, valid business reasons may lead the predecessor to decide not to allow access to the work papers. In addition, predecessors are not obligated to make themselves or their work papers available to more than one prospective successor.
Practice Pointer. Unpaid fees constitute a valid business reason for a predecessor accountant to deny access to his or her work papers. However, unpaid fees do not represent an unusual circumstance that would prevent the predecessor from fully responding to your inquiries.

Materially misleading financial statements. If, during the engagement, you become aware of information that causes you to believe that the financial statements reported on by the predecessor may need to be revised, you should ask the client to communicate the matter to the predecessor. If the client refuses to do so, or if the predecessor’s course of action is inadequate, you should consult with an attorney.

Change in Engagement

Occasionally, during the course of an engagement, the client may ask you to change the nature of the engagement. The request may be for a:

- Step-up—for example, from a management-use-only compilation to a traditional compilation or from a traditional compilation to a review.

- Step-down—for example, from a traditional compilation to a management-use-only compilation, or from a management-use-only compilation to bookkeeping services.

Step-ups. SSARS No. 1 does not specifically address step-ups. Generally, step-ups pose no issues of great concern. If the client needs financial statements for third-party use, you may compile (or review) financial statements for that client and comply with the reporting requirements in SSARS No. 1, as amended (AR sec. 100.11-.19) (or follow requirements for a review engagement). Note that you may do this even if you have previously compiled the financial statements for management’s use only. In these circumstances, compilation of financial statements for third-party use would, however, be a different engagement.

Practice Pointer. You may want to include language in the engagement letter alerting the client to the fact that if he or she needs financial statements for third-party use, you can provide that service separately (see illustrative engagement letter in Appendix C).

Step-downs. You can agree to a request to step-down from a traditional compilation to a management-use-only compilation if (1) you do not reasonably expect the financial statements to be used by a third party, (2) nothing comes to your attention that contradicts management’s representation that the financial statements will not be used by a third party, and (3) you document your understanding with the client through the use of a written engagement letter.

You can agree to a request to step-down from a management-use-only compilation to bookkeeping services if you feel that your services will not constitute preparing and presenting financial statements to the client or third parties.
Management-Use-Only Financial Statements Distributed to Third Parties

SSARS No. 1, as amended (AR sec. 100.23), states the following:

If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and request that the client have the statements returned. If the client does not comply with this request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third-party use, preferably in consultation with his or her attorney.

If you determine that the financial statements were given to a third party unintentionally (for example, the client made a mistake or forgot about the restricted nature of the financial statements), you should remind the client of the restricted nature of the statements and request that he or she retrieve all copies from third parties. If the client complies, there is no need for further action on your part.

However, if you discover that the client intentionally disregarded the restriction placed on the use of the financial statements, and if the client refuses to retrieve the financial statements, then you should notify known third parties that the financial statements are not intended for third-party use. You also might consider how such an action on your client’s part to intentionally disregard the distribution restriction bears on management’s integrity and, as a result, on your performance of any further services for that client.

Some practitioners have suggested that the potential risk of third-party distribution is high and, therefore, may avoid performing the management-use-only type of compilation. However, in our profession, there are other restricted-use professional services that we offer (for example, agreed-upon procedures engagements and projections). If the management-use-only engagement is performed correctly, including obtaining a written engagement letter and placing a legend indicating the restricted nature of the presentation on each page of the financial statements, then the risk of third-party distribution should be very low.

Practice Pointer. Notification of third parties would involve legal matters beyond the scope of this Practice Aid. Therefore, you should consult with an attorney before taking any action.

In order to minimize the risk of a client distributing management-use-only financial statements to third parties, you may want to include language in the engagement letter alerting the client to the fact that if he or she needs financial statements for third-party use, you can provide that service separately (see illustrative engagement letter in Appendix C).
Engagement Performance

Performance Standards

SSARS No. 1, as amended, states that, in all compilation engagements, the performance standards in AR sections 100.05 and 100.07-.10 should be followed. These performance standards consist of:

- **Establish an understanding with the entity.**

  You should have an understanding with the entity about the nature and limitations of the services to be performed and a description of the report, if a report is to be issued. The understanding should also provide (1) that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts and (2) that you will inform the appropriate level of management of any material errors that come to your attention and any fraud or illegal acts that come to your attention, unless they are clearly inconsequential. This understanding should preferably be in writing. However, if the engagement is to compile financial statements for management’s use only, a written engagement letter is required.

- **Have or obtain a general understanding of the accounting principles and practices of the industry in which the client operates.**

  You should have a sufficient understanding of your client’s industry to know what the financial statements for an entity in that industry should look like and to be aware of any accounting principles or practices that are unique to that industry. You do not have to be an industry expert, and you can obtain this general understanding if you do not already possess it (for example, through AICPA guides, nonauthoritative industry guides, and trade publications).

- **Have or obtain a general understanding of the client’s business.**

  You should have a general understanding of the client’s business transactions, form of its accounting records, stated qualifications of accounting personnel, basis of accounting on which the financial statements are to be presented, and form and content of the financial statements, according to the standard. The purpose of this general understanding is to determine whether it will be necessary for you to perform other accounting services (such as bookkeeping and adjustments) in order to compile the financial statements.

- **Obtain additional or revised information if the information supplied by the client appears to be incorrect, incomplete, or otherwise unsatisfactory.**

  This requirement to obtain additional or revised information has different meanings depending upon the intended use of the financial statements. For example, if the financial statements will be used by a third party (or if you reasonably expect that they might be used by a third party),
any information that appears to be incomplete, incorrect, or unsatisfactory for use by that third party (for example, missing disclosures or measurement departures) should be obtained from or corrected by the client. On the other hand, if the financial statements are not intended to be used by third parties, then that same information may be sufficient for management, since they have the requisite knowledge of the business to put the information in the proper context.

**Practice Pointer.** A client information form, which may be helpful in gaining an understanding of the client’s business, is included in Appendix B of this Practice Aid.

- *Read the compiled financial statements and consider whether they appear to be appropriate in form and free of obvious material error.*

This final reading of the financial statements is sometimes called the “smell test.” The primary purpose of the smell test requirement is to look for mathematical or clerical errors, presentation errors (for example, incorrect titles on the financial statements), and others.

A “Management-Use-Only Compilation Engagement Checklist” is included in Appendix F of this Practice Aid. Although a checklist is not required (and need not be documented), it may be an efficient way to address each of the required performance standards.

**Communication Requirements**

As discussed previously in this Practice Aid, if you submit financial statements to a client that will be used by a third party (or if you reasonably expect that they might be used by a third party), you must comply with the reporting requirements in SSARS No. 1, as amended (AR sec. 100.11-.19). And, if the financial statements are for management’s use only (and you do not reasonably expect them to be used by a third party), there is an additional communication option: a written engagement letter (preferably signed by management). The requirements for the written engagement letter are discussed in the “Management-Use-Only Compilation Engagement Letters” section, earlier in this Practice Aid.

**Documentation**

SSARS No. 1 does not discuss work paper documentation for a compilation engagement (except in the case of the engagement letter in a management-use-only compilation). However, most practitioners include the following in compilation work papers:

- Engagement letter (required to be documented in a management-use-only compilation).

- Checklist or memorandum describing the CPA’s knowledge of the client’s business and industry.

- Documentation that the CPA read the compiled financial statements.
• Client data used for drafting notes to the financial statements.

• Discussion of unusual matters encountered.

• Reasons for omission of all, or substantially all, disclosures.

• Description of any related accounting or bookkeeping services performed preparatory to the compilation.

• Reasons for a step-down from another engagement, if applicable.

It’s wise to document all client discussions, in person or over the phone. Notations should identify all parties to the discussion, what was said, and by whom. Entries should be initialed and dated by the practitioner. Also, consider potential consequences to the client if they ignore, misinterpret, or fail to act on advice or conclusions. If such actions could result in lost financial benefits or adverse tax consequences to the client, or if action by other professionals is recommended or required, send a follow-up letter to the client explaining the substance of your discussions and detailed recommendations.

Never include unsubstantiated subjective statements in a working paper file. If documenting observations regarding questionable client ethics or possible fraud, list the objective findings that led to this observation. In addition, timesheets should reflect and accurately describe work performed during the engagement. Avoid using terms like “audit” and “review,” unless the service performed fits the definitions contained in the AICPA professional standards.

Practice Pointer. Remember—all relevant information is potentially subject to discovery in a lawsuit, regardless of the storage medium.

When to Withdraw From the Engagement

You should consider withdrawing from a management-use-only compilation engagement if any of the following conditions exist:

• You determine that you do not have and cannot obtain sufficient knowledge of the client’s business or industry.

• The client refuses or is unable to provide additional or revised information when you request it.

• Information comes to your attention that contradicts management’s representation that financial statements compiled for management’s use only will not be used by third parties.
Form and Content of the Financial Statements

Transmittal Letter

Some practitioners have questioned whether they should include a transmittal letter with financial statements compiled for management’s use only. While a transmittal letter is not required by SSARSs, it is permissible to attach such a letter to management-use-only financial statements. This letter, however, should not contain any language that resembles that found in a traditional compilation report.

Basis of Accounting and Financial Statement Titles

In SSARS No. 1, as amended (AR sec. 100.04), a financial statement is defined as the following.

A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity’s economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP) or a comprehensive basis of accounting other than GAAP [OCBOA].

Theoretically, to be considered financial statements, management-use-only financial statements should be prepared using GAAP or OCBOA. However, as with any compiled or reviewed financial statements, there may be departures from that basis (measurement, presentation, or disclosure). Financial statements that are or might reasonably be expected to be used by a third party should include a report identifying these departures. Management-use-only financial statements will not include a report; however, the engagement letter may identify departures. The fact that departures may exist in these financial statements does not mean that the financial statements are not prepared using GAAP or OCBOA. As a result of the restricted nature of the financial statements, however, there is no need to identify the particular basis of accounting being used because management was involved in designing the financial statements to provide the best information available for managing their business. Consequently, they are already aware of the limitations of the financial statements, including the fact that they may not be prepared in strict conformity with GAAP or OCBOA.

In addition, titles such as “Income Statement” or “Balance Sheet” should only be used on GAAP financial statements. Appropriate titles for OCBOA financial statements include “Statement of Assets, Liabilities, and Equity—Income Tax Basis” or “Statement of Revenues and Expenses—Cash Basis.” However, as a result of the restricted nature of these financial statements, strict adherence to proper titles is not always necessary. Management should understand and be able to use the financial statements. Therefore, any reasonable title that management understands would be appropriate.
Legend on Each Page of the Financial Statements

SSARS No. 1, as amended (AR sec 100.21), requires that you place a legend on each page of the financial statements restricted to management’s use only indicating the restricted nature of the presentation (meaning restricted to management use), such as “Restricted for Management’s Use Only” or “Solely for the information and use of the management of XYZ Company and is not intended to be and should not be used by any other party.” Although a legend is required, you do not have to use either of these two examples as long as you indicate the restricted nature of the financial statements. Some practitioners may choose more descriptive legends, such as the following:

- These financial statements are for use by management only and should not be relied upon by others. These statements may contain material departures from generally accepted accounting principles, and the effects of those departures, if any, are not disclosed.

- Restricted for Management Use Only—Not for External Use

Since the financial statements are intended to be restricted to management’s use, the use of the words “Internal Use” should be avoided.

Practice Pointer. This legend may be placed on the financial statements by installing footers in financial statement software, by using a rubber stamp, by manually writing the legend, or by using any other method that is practical for the accountant.

Supplementary Information

Two common questions arise when supplementary information is included with the basic financial statements:

1. What is considered supplementary information, and where do I place it in the presentation?

2. Do I have to modify my communication if supplementary information is included?

The term “supplementary information” is not defined in SSARSs. SAS No. 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AICPA, Professional Standards, vol. 1, AU sec. 551), defines this type of information as:

- Additional details of items in, or related to, the basic financial statements, unless the information has been identified as being part of the basic financial statements

- Consolidating information

- Historical summaries of items extracted from basic financial statements, including graphs prepared on a computer

- Statistical data
• Other material, some of which may be from sources outside the accounting system or outside the entity

**Practice Pointer.** Normally, supplementary information is separated from the basic financial statements. Most practitioners present supplementary information on separate pages after the basic financial statements (and footnotes, if included). It is also a good idea to separate the supplementary information from the basic financial statements by including a title page marked: “Supplementary Information.”

Financial statements often include detailed schedules, summaries, comparisons, or statistical information that are not part of the basic financial statements, such as:

• Budgets for an expired period
• Cost of goods sold schedule
• Manufacturing expenses schedule
• Selling expenses
• General and administrative expenses
• Details of marketable securities
• Property and equipment schedule
• Aging analysis of accounts receivable
• Details of sales by product line, territory, or salesperson

SSARS No. 1 requires that you indicate the degree of responsibility, if any, you are taking with respect to the supplementary information that accompanies the basic financial statements. In a management-use-only compilation, the indication of the degree of responsibility is included in the engagement letter, as follows:

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and we will not express an opinion or any other form of assurance on such data.

**Comparative Financial Statements**

You may present comparative financial statements (financial statements of two or more periods presented in columnar form) that have been compiled for management-use only. For example, you may compile monthly financial statements and present them together with year-to-date financial statements in columnar form. Or, you may compile monthly financial statements and
present them together with the same period from the previous year. Any comparative presentations are suitable as long as all financial statements presented are restricted for management use only (all periods presented should be addressed in the engagement letter).

Should the client need comparative financial statements for third-party use, you should comply with the SSARS No. 1 reporting requirements for both periods before issuing the report on the comparative statements (AR sec. 100.11-.19). SSARS No. 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200), contains guidance for reporting when one or more periods is compiled (traditional—with a report), reviewed, or audited. Guidance in SSARS No. 2 is not applicable to any situations involving financial statements compiled for management use only.

**Other Implementation Issues**

**Correlation With Other Professional Services**

According to SSARS No. 8, financial statements may be compiled for management’s use only as long as the financial statements are not expected to be used by third parties. In many business entities, this determination is not difficult to apply. However, if the client is an individual, not-for-profit, or governmental entity, it is important to exercise care when it comes to the use of management-use-only financial statements. Table 2 may be helpful in making these judgments about compilations for management use only.

**Table 2** Determining Whether Compilations Are for Management Use Only

<table>
<thead>
<tr>
<th>Engagement</th>
<th>Management-Use-Only Compilation Allowed?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Personal financial statements</td>
<td>Yes, as long as the financial statements are restricted to management use only. In this context, only the individual whose financial statements are presented would be considered management. Note that the individual’s advisers (for example, attorney, financial planner, banker) would be considered third parties. However, SSARS No. 6, <em>Reporting on Personal Financial Statements Included in Written Personal Financial Plans</em> (AICPA, <em>Professional Standards</em>, vol. 2, AR sec. 600), provides for an exemption from SSARS No. 1 for personal financial statements included in written personal financial plans. Under SSARS No. 6, the personal financial plan may also be used by the individual’s advisers to assist in implementing the plan.</td>
</tr>
</tbody>
</table>
### Engagement | Management-Use-Only Compilation Allowed?
--- | ---
ElderCare services | Yes. As long as the financial statements are restricted to management use only. In this context, whoever is responsible for achieving the objectives of the individual and who has the authority to establish policies and make decisions by which those objectives are to be pursued would be considered management.

Not-for-profit organizations | Yes, as long as the financial statements can be restricted to management use only. However, if the organization’s financial information is subject to public examination, then management-use-only financial statements would not be appropriate because management cannot legally agree to restrict the financial statements to management’s use only.

Note that if expired budget information is included (for example, actual versus budget presentations), this information is considered supplementary information and would simply be referred to in the engagement letter.

Trusts or estates | Yes, as long as the financial statements are restricted to management use only. In this context, whoever is responsible for achieving the objectives of the trust or estate and who has the authority to establish policies and make decisions by which those objectives are to be pursued would be considered management. Generally, this would be the trustee or executor, but not the beneficiaries.

Governmental entities | No. Since a governmental entity’s financial information is subject to public examination, management-use-only financial statements would not be appropriate because management cannot legally agree to restrict the financial statements to management’s use only.

### Controllership Services

Many CPAs in public practice perform services for clients that are equivalent to those ordinarily performed by management. These services may entail making management decisions for a client and could include services such as the following:

- Hiring and terminating employees
- Authorizing purchases or expenditures
- Disbursing funds
• Making investment decisions
• Having custody of assets
• Making credit decisions
• Signing contracts
• Serving as an officer of the entity

A debate has been going on for some time as to whether a CPA who performs these services for a client should comply with SSARS No. 1 in connection with any financial statements he or she submits. On one hand, it can be argued that the CPA is, in substance, part of management and therefore should not perform a compilation on the financial statements that he or she prepares (CPAs in industry are not required to comply with SSARS No. 1). On the other hand, it can be argued that the CPA is in public practice and should, therefore, perform a compilation.

ARSC is expected to issue specific guidance on compliance with SSARS in the near future. In the meantime, preparing management-use-only financial statements may be useful. You would comply with the requirements for a management-use-only compilation by preparing a written engagement letter and following the compilation performance standards for any financial statements that you submit while performing these controllership services.

Practice Pointer. Keep in mind, however, that the financial statements would be restricted to management’s use only and not available to third parties. In addition, because of the nature of the services performed, you would need to add an item to the engagement letter noting your lack of independence.

Peer Review Implications

In general, in order to maintain membership in the AICPA, any firm or individual who performs engagements resulting in a report being issued under the professional standards must be enrolled in an Institute-approved practice monitoring program. Historically, this has meant that any firm or individual that performs audits, reviews, compilations, or other attestation engagements was subject to peer review. However, financial statements compiled for management’s use only do not include a report, theoretically putting them outside the purview of peer review.

The Peer Review Board has determined that if a compilation for management’s use is issued with an engagement letter, not with a report, and is the only accounting and auditing service performed by the firm, the firm would not be required by the AICPA to enroll in an Institute-approved practice monitoring program. If a firm is already enrolled in such a program and performs management-use-only compilation engagements, these engagements would be included in the definition of the firm’s accounting and auditing practice and would be within the scope of peer review.
Since peer review is administered by the individual states, you should consult with your state CPA society (or other organization responsible for conducting peer review) to determine the appropriate course of action in your own state. Specifically, you should check to see if your state follows the AICPA guidance for enrollment in a practice monitoring program. In some states, enrollment is based on factors other than issuing reports. You can find a complete list of all state CPA societies and state boards of accountancy at www.aicpa.org.

**Effective Date**

SSARS No. 8 is effective for financial statements submitted after December 31, 2000. Therefore, the new definition of submission became operable on January 1, 2001, as well as financial statements restricted for management’s use only (compiled without a report).

**Implementation Survey Results**

The changes brought about by SSARS No. 8 were effective as of the beginning of 2001. Since that time, many CPAs around the country have begun to implement SSARS No. 8 changes. The more subtle of the changes (definition of “submission”) has been well received. A major professional liability insurance company stated in its spring newsletter, “...the redefining of what constitutes a submission of financial statements...is a real plus to the profession. It should help to clarify much of the confusion in this area for CPAs who were rendering true bookkeeping services...and yet felt vulnerable to noncompliance with SSARS standards.”

Early in 2001, the New York State Society of CPAs surveyed its members concerning the issuance of SSARS No. 8. Although this survey focused primarily on the management-use-only compilation (no questions in the survey addressed the change in the definition of submission), it provides interesting insight into the average practitioner’s view of SSARS No. 8.

Of the total respondents, 91 percent were from small- and medium-size firms. Of these firms, 71 percent indicated that they did plan to perform management-use-only compilations. Common reasons cited included time savings on engagements and the ability to provide an additional level of service to clients.

Of the small percentage that indicated that their firms would not offer management-use-only compilations, common reasons cited were potential liability for third-party use and no significant improvement in engagement efficiency. Finally, one respondent commented that SSARS No. 8 is “A real plus to the small client. A great help to the small, local CPA!”
Implementation Questions and Answers

These Q&As have been included to summarize some of the most frequently asked questions about SSARS No. 8.

During the two years of discussions, debates, and comment letters, the ARSC continuously stressed the need for educating practitioners about the changes that were being proposed. As questions arose, the ARSC documented these along with the answers that they agreed upon. The result is the following list of the most frequently asked questions about SSARS No. 8.

1. What are the communication options in a compilation engagement?

The type of communication you use depends upon the intended use of the financial statements. If the financial statements will be used by a third party (or if you reasonably expect that they might be used by a third party), then a compilation report is the only appropriate communication. If you do not reasonably expect a third party to use the compiled financial statements, you have two options:

a. Issue a compilation report (in other words you may choose to perform a “traditional compilation”), or

b. Document your understanding with the client in an engagement letter, preferably signed by management.

See the “Management-Use-Only Compilation Engagement Letters” section of this Practice Aid for a discussion of what to include in the engagement letter and see Appendix C, “Illustrative Engagement Letter—Management-Use-Only Compilation,” for an illustrative engagement letter.

2. Has issuance of SSARS No. 8 affected the performance or reporting standards for review engagements?

No. The performance and reporting standards for review engagements have not changed.

3. Can I make a statement that the financial statements are “not presented in conformity with generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting (OCBOA)”? Do I have to identify each and every measurement departure from GAAP or OCBOA?

No. Including such a statement in a compilation report would be tantamount to expressing an adverse opinion on the financial statements taken as a whole.

If the financial statements are accompanied by a report, then each known departure that would have a material effect on the financial statements must be either corrected or identified, along with the effect of the departure on the financial statements (if the effect is known).
If the financial statements are for management’s use only, then a statement can be made in the engagement letter that “material departures from GAAP or OCBOA may exist and the effects of these departures, if any, on the financial statements may not be disclosed.”

4. Can I perform a compilation if I am not independent?

Yes, as long as you disclose the lack of independence. If the financial statements are accompanied by a report, then you would add a paragraph to the compilation report indicating lack of independence. If the financial statements are for management use only, then a statement is added to the engagement letter. In either case, the disclosure should read as follows:

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

5. How do I determine if I am independent?

Rule 101 of the AICPA Code of Professional Conduct along with the related Interpretations of Rule 101 and independence rulings provide guidance for determining independence.

6. What kind of legend is required on compiled financial statements?

If the financial statements are accompanied by a report, then each page of the financial statements should include a reference to the report, such as:

See accountant’s compilation report.

If the financial statements are for management’s use only, then each page of the financial statements should include a reference to the restricted nature of the financial statements, such as:

Restricted for Management’s Use Only.

(or)

Solely for the information of and use by the management of XYZ Company and not intended to be and should not be used by any other party.

7. May I issue a standard compilation report on financial statements that have previously been compiled for management’s use only?

Yes. However, you would have to comply with the reporting requirements in SSARS No. 1 before issuing the compilation report.

8. May I compile interim financial statements (for example, monthly or quarterly) that are restricted to management’s use only and then issue a standard compilation report on the year-end financial statements?
Yes. However, the compilation of the year-end financial statements would be considered a separate engagement and would be subject to both the performance standards and reporting standards in SSARS No. 1.

9. **What should I do if I discover that financial statements that were restricted to management’s use only have been distributed to third parties?**

The first step should be to discuss the situation with the client and remind him or her of the restricted nature of the financial statements. You should also request that the client retrieve any copies of the financial statements that have been distributed to third parties. If the client complies with this request, no further action is necessary.

If the client does not comply with this request within a reasonable period of time, you should attempt to notify known third parties that the financial statements are not intended for third-party use. Since this action will involve complex legal issues, you should consult with an attorney before proceeding.

10. **May I submit “draft” management-use-only financial statements?**

Yes, as long as you have complied with all performance requirements in SSARS No. 1, as amended (AR sec. 100.05 and .07-.10). These “draft” management-use-only financial statements should still contain the legend indicating the restricted nature of the financial statements in order to minimize the risk of misunderstanding about the intended users of the financial statements.

11. **May I use the new communication option (engagement letter) for a prescribed form under SSARS No. 3?**

No. SSARS No. 3, *Compilation Reports on Financial Statement Included in Certain Prescribed Forms* (AICPA, Professional Standards, vol. 2, AR sec. 300), provides guidance for reporting on financial statements contained in certain prescribed forms. Since the intended user of these financial statements is generally a third party (for example, a bank or an industry association), the new communication option would not be appropriate.

12. **May I issue a standard compilation report on comparative statements when the prior-period financial statements were restricted to management’s use only?**

Yes. However, you will have to comply with the SSARS No. 1 reporting requirements for both periods before issuing the report on the comparative statements. In other words, the reporting requirements in SSARS No. 1, as amended (AR sec. 100.11-.19), would apply to both periods.

13. **May I issue management-use-only financial statements for an individual (that is, personal financial statements)?**
Yes. You can do this as long as the financial statements are restricted to management’s use only. In this context, only the individual whose financial statements are presented would be considered to be management.

14. **May I include supplementary information with management-use-only financial statements?**

Yes. You may include supplementary information which may include charts, graphs, tables, or details of financial statement line items with the financial statements. You should include a statement in the engagement letter indicating your level of responsibility with respect to the supplementary information, such as:

> The other data accompanying the financial statements are presented only for supplementary analysis purposes and were compiled from information that is the representation of management, without audit or review, and we do not express an opinion or any other form of assurance on such data.

15. **Is it possible for someone who is a third party to become a non-third party?**

Yes, as long as that party is a member of management. In order to be considered a non-third party, the person must meet two tests:

a. He or she is a member of management.

b. He or she is knowledgeable enough about the business to put the information in the proper context.

If the person is not generally knowledgeable about and does not understand the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements, he or she can be educated and “brought into the loop.” This education can be done by other members of management or by the accountant.

16. **If I am engaged to perform a standard compilation, may I change the engagement to a management-use-only engagement?**

Yes. However, as with any situation involving a change in the kind of engagement, you should carefully consider the reason for a request for a change in the engagement. You may compile financial statements restricted to management’s use only if you do not reasonably expect that they will be used by a third party.

17. **If I am engaged to perform a management-use-only compilation engagement, may I change the engagement to a standard compilation?**

Yes.

18. **Can I issue one engagement letter to cover multiple periods?**
Yes. Engagement letters that cover an entire year are very common and may address multiple services. However, it is recommended that engagement letters be updated at least annually.

19. If a client has bank debt, can I ever reasonably expect that the financial statements will not be used by a third party?

Yes. The mere fact that a client has bank debt will not preclude you from compiling financial statements for management’s use only. You should, however, explain to the client that management-use-only financial statements are not intended to be used by the bank (or any other third party). If and when the client needs financial statements for distribution to the bank or others, you may discuss with him or her the requested level of service. You would not be precluded from compiling financial statements with a report when requested to do so.

20. Can I omit the statement of cash flows from financial statements restricted for management’s use only?

Yes. When the statement of cash flows is omitted, the engagement letter should contain a statement such as the following:

Substantially all disclosures (and the statement of comprehensive income and statement of cash flows) required by generally accepted accounting principles (or an other comprehensive basis of accounting) may be omitted.

21. Do compiled financial statements have to contain footnotes?

In general, financial statements should include appropriate footnote disclosures. However, compiled financial statements may omit those disclosures as long as that omission is disclosed and as long as the accountant is not aware of any intention to mislead the user of the financial statements.

This omission is disclosed either in the compilation report or in the engagement letter (for financial statements restricted to management’s use only).

In the compilation report, the omission is disclosed as follows:

Management has elected to omit substantially all disclosures (and the statement of comprehensive income and statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures 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, these financial statements are not designed for those who are not informed about such matters.
In the engagement letter (for financial statements restricted to management’s use only) the disclosure would be as follows:

Substantially all disclosures (and the statement of comprehensive income and statement of cash flows) required by generally accepted accounting principles (or an other comprehensive basis of accounting) may be omitted.

22. What titles should be used on financial statements restricted to management’s use only?

In general, titles such as “Income Statement” or “Balance Sheet” should only be used on GAAP financial statements. Appropriate titles for OCBOA financial statements include “Statement of Assets, Liabilities, and Equity—Income Tax Basis” or “Statement of Revenues and Expenses—Cash Basis.” However, as a result of the restricted nature of these financial statements, strict adherence to proper titles is not always necessary. Since these financial statements are designed to meet management’s needs in managing their business, you should use titles that management understands.
Appendix A: Client Acceptance Form

Completed by: ______________________________ Date: _______________________________

BACKGROUND INFORMATION
Client name: ______________________________ Fiscal year end: ______________________
Billing address: _____________________________________________________________________
_________________________________________________________________________________
_________________________________________________________________________________
_________________________________________________________________________________
Telephone no.: _____________________________________________________________________
Fax no.: _________________________________________________________________________
E-mail address: ___________________________________________________________________
Type of legal entity: __________________________________________________________________

Describe the client’s business.

List the key officers or principals of the company.

If the company’s accounting services are now being performed by another accounting firm, identify the firm, the reason the company gives for considering a change to our firm, and whether there are disagreements with the prior firm over accounting principles.

If we have communicated with the company’s prior accounting firm, also document any comments regarding the integrity and cooperation of management, any disagreements about accounting policies or procedures, and the predecessor’s understanding of the reason for the change.
Briefly describe the services our firm is to perform.

Describe our fee arrangements and, if practical, attach a schedule showing an estimate of the fees.

**ACCEPTANCE QUESTIONNAIRE**

1. Is there any reason to doubt the integrity of the company’s management or officers?

2. Are we aware of any independence problems or conflicts of interest because of relationships with other clients, partners, or staff?

3. Are we aware of any fee collection problems?

4. Does the fee arrangement violate the AICPA’s Code of Professional Conduct related to independence, for example, through acceptance of equity interests, or rules on contingent fees and commissions?

5. Is the professional competence (expertise) necessary to perform the engagement beyond our capabilities?

6. Is the staffing commitment required by the job within our capabilities?

7. Are there disagreements with the present firm over accounting principles?

8. Is there anything about the engagement (including the risk associated with the engagement) that subjects us to undue liability exposure, particularly to third parties, or causes us to be uncomfortable about being associated with the client?

**COMMENTS:** A “yes” response does not necessarily indicate that the prospective engagement should be rejected. However, for any “yes” responses, explain the steps that we plan to take to mitigate the situation, for example, closer supervision, a substantial fee deposit before work can start, assistance from another firm, and so on.

**CONCLUSION**

We should accept ______ or not accept ______ the engagement.

Engagement partner: ___________________________ Date: ______________________________

Concurring partner: ___________________________ Date: ______________________________
Appendix B: Client Information Form

Client: _____________________________________ Fiscal year end: ____________________

KNOWLEDGE OF ACCOUNTING PRINCIPLES AND PRACTICES OF CLIENT’S INDUSTRY

A. Describe the industries in which the company operates.

B. List any AICPA guides, industry publications, and so on, that represent authoritative sources for the accounting principles and practices applicable to the company’s industries and describe any specialized accounting practices or principles that are appropriate or unique to these industries.

C. Describe any accounting principles or practices followed by the company that are unique to or different from those normally followed by companies in the same industry.

UNDERSTANDING OF THE CLIENT’S BUSINESS

Company Organization and Personnel

A. Describe the company’s capital structure. List the major stockholders of the company and percentage of ownership, if known.

B. List all related parties, for example, subsidiaries, affiliated companies including partnerships, joint ventures, and so on.

C. List the principal members of management.

D. Indicate, by major location, the approximate number of employees of the company.
Company Operating Characteristics

A. List each location maintained by the company and the nature of the activity carried on at each, for example, plant, sales office, executive offices, and so on.

B. Describe the nature of the company’s major assets and liabilities.

C. Indicate the company’s primary sources of revenue (for example, major product lines) and approximate percentage of total revenue generated by each.

D. Describe the components of cost of goods sold.

E. Describe any concentrations (such as major customer, suppliers, and so on).

F. List the major expenses of the company other than cost of goods sold.

G. Describe the company’s marketing methods.

H. Describe the company’s production process.

I. Describe the company’s compensation methods, for example, salary, hourly wage, commissions, piece work, union scale, frequency and timing, and so on.
J. Briefly describe whether the company has a pension or profit-sharing plan or provides other post-employment benefits and identify those plans and benefit programs.

K. Describe transactions with related parties.

**ACCOUNTING PRINCIPLES USED BY THE COMPANY**

A. If the statements are not presented on a generally accepted accounting principles (GAAP) basis, explain the basis and the reason for using it.

B. Briefly describe the company’s significant accounting policies, for example, inventory method, depreciation method, and so on.

C. Briefly describe how often physical inventories are taken and the techniques used.

D. Briefly describe any significant estimates used to prepare the statements.

**COMPANY ACCOUNTING SYSTEM**

A. Briefly describe the accounting system and accounting responsibilities.

Name of accounting software package:
<table>
<thead>
<tr>
<th>Description of Accounting Record</th>
<th>Person at Client or Firm Who Is Responsible</th>
<th>Computer</th>
<th>Manual</th>
<th>N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>General ledger</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subsidiary ledgers:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts receivable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property and equipment</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans payable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Perpetual inventory</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Physical inventory summary</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Journals:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash disbursements</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sales/purchase/voucher</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payroll</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>General journal entries</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial reporting:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monthly financial statements</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management reports</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank reconciliations</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
B. Give the stated qualifications of the company’s accounting personnel.

C. Describe any unusual features of the accounting system.

D. Briefly describe the company’s completeness procedures and methods to ensure that accounting transactions enter into the accounting system, for example, that all shipments or services are invoiced, that all sales are recorded, and that all disbursements are recorded.

Prepared (or updated) and reviewed by:

<table>
<thead>
<tr>
<th></th>
<th>Initial</th>
<th>Date</th>
<th>Initial</th>
<th>Date</th>
<th>Initial</th>
<th>Date</th>
<th>Initial</th>
<th>Date</th>
<th>Initial</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>In-charge</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>accountant</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Partner</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Appendix C: Illustrative Engagement Letter—Management-Use-Only Compilation*

[Appropriate Salutation]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the [monthly, quarterly, or other frequency] financial statements of XYZ Company for the year 20XX. A compilation is limited to presenting in the form of financial statements information that is the representation of management. We will not audit or review the financial statements and accordingly, will not express an opinion or any other form of assurance on them. The financial statements will not be accompanied by a report.

   Based upon our discussions with you, these financial statements are for management’s use only and are not intended for third-party use.

   Material departures from generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (OCBOA) may exist and the effects of those departures, if any, on the financial statements may not be disclosed. In addition, substantially all disclosures required by GAAP or OCBOA may be omitted. [The accountant may wish to identify known departures.] Notwithstanding these limitations, you represent that you have knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements that allows you to place the financial information in the proper context. Further, you represent and agree that the use of the financial statements will be limited to members of management with similar knowledge.

   The financial statements are intended solely for the information and use of [include list of specified members of management] and are not intended to be and should not be used by any other party.—[optional]

* Source: Statement on Standards for Accounting and Review Services No. 8, Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100.56).
2. We will also [discussion of other services—optional].

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention, unless clearly inconsequential.

We are not independent with respect to [name of entity].—[if applicable]

The other data accompanying the financial statements are presented only for supplementary analysis purposes and will be compiled from information that is the representation of management, without audit or review, and we will not express an opinion or any other form of assurance on such data.—[if applicable]

In view of the limitations described above, you agree not to take or assist in any action seeking to hold us liable for damages due to any deficiency in the financial statements we prepare and you agree to hold us harmless from any liability and related legal costs arising from any third-party use of the financial statements in contravention of the terms of this agreement.[optional]

Our fees for these services [fill in].

Should you require financial statements for third-party use, we would be pleased to discuss with you the requested level of service. Such engagement would be considered separate and not deemed to be part of the services described in this engagement letter.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\(^1\)

Sincerely yours,

[Signature of accountant]

Accepted and agreed to:

XYZ Company

Title

Date

\(^1\) Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning, “If the foregoing…” and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: “This letter sets forth our understanding of the terms and objectives of our engagement…”
Appendix D: Illustrative Engagement Letter—Traditional Compilation*

[Appropriate Salutation]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and cash flows of XYZ Company for the year 20XX. We will not audit or review such financial statements. Our report on the annual financial statements of XYZ Company is presently expected to read as follows:

   I (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, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

   A compilation is limited to presenting in the form of financial statements information that is the representation of management. We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Our report on your interim financial statements, which statements will omit substantially all disclosures, will include an additional paragraph that will read as follows:

   Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures 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, these financial statements are not designed for those who are not informed about such matters.

   If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will also... [discussion of other services].

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention, unless they are clearly inconsequential.

Our fees for these services...

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

[Signature of accountant]

Acknowledged:

XYZ Company

President

Date
Appendix E: Illustrative Engagement Letter—Bookkeeping Services

[Appropriate Salutation]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide. So that we can meet your expectations related to the services we will provide, this engagement letter clearly identifies both the services that will be provided and the frequency with which these services will be provided.

We will prepare semimonthly payroll checks and compute required withholdings based on hours worked, rates of pay, tax jurisdictions, and withholding information provided by you [or your representative]. You will need to review all payroll checks prior to signing them, and notify us [promptly] of any errors. We will notify you of required payroll tax deposits. Failure to make these deposits [on a timely basis] will subject you to penalties and interest.

We will prepare quarterly and annual payroll tax returns, as well as your annual 1099 forms. You will need to review the returns prior to signing them, and notify us [promptly] of any errors or omissions.

Any significant changes in the number of employees, various miscellaneous deductions, or other items involved could cause an increase in our fees. We also require that you provide complete information [in good “working order” for us], with checks and deposits coded to the proper accounts. We will discuss with you [in advance] any proposed increase in our fees.

We will also assist you with various bookkeeping functions, including consultation on recordkeeping, recording of transactions, and periodic adjustments, among others.

Our work in connection with this engagement is not intended to result in submission or issuance of financial statements by [Firm] as defined by Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. A submission of financial statements as defined by professional standards, requires that the CPA present to a client or third parties financial statements that the CPA has prepared manually or through the use of computer software. By your signature below, you understand that the submission of financial statements as defined above is outside the scope of this engagement.

Should you require financial statements (either for management use or third-party use), we would be pleased to discuss with you the requested level of service. Such engagement would be considered separate and not deemed to be part of the services described in this engagement letter.
Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts that may exist. However, we will inform the appropriate level of management of any material errors that come to our attention and any fraud or illegal acts that come to our attention [unless they are clearly inconsequential].

We appreciate the opportunity to be of service to you and believe that this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If the foregoing terms are in accordance with your understanding, please sign the copy of this letter [in the space provided] and return it to us.

Sincerely yours,

[Signature of accountant]

Accepted and agreed to:

XYZ Company

Title

Date
# Appendix F: Management-Use-Only
## Compilation Engagement Engagement Checklist

<table>
<thead>
<tr>
<th>Client: ______________________________</th>
<th>Balance sheet date: __________________</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completed by: _______________________</td>
<td>Date completed: ______________________</td>
</tr>
</tbody>
</table>

### Procedure

<table>
<thead>
<tr>
<th></th>
<th>Completed by or N/A</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Prepare or update the Client Acceptance Form.</td>
</tr>
<tr>
<td>2.</td>
<td>Consider whether the firm is independent. If not independent, the engagement letter should be modified to indicate that fact.</td>
</tr>
<tr>
<td>3.</td>
<td>Establish an understanding with the client, in writing, regarding the following and include a copy of the engagement letter in the work papers.</td>
</tr>
</tbody>
</table>
<pre><code> | b. Management has knowledge of the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements. |
 | c. Management representation that financial statements are not to be used by third parties. |
 | d. Engagement cannot be relied upon to disclose errors, fraud, or illegal acts. |
 | e. We will inform appropriate level of management of any material errors that come to our attention, unless clearly inconsequential. |
</code></pre>
<p>| 4. | If the engagement was originally intended to be another type of engagement, document the appropriateness of the decision to change the engagement. |</p>
5. Acquire the necessary knowledge and understanding of:
   a. Accounting principles and practices of the industry.
   b. Nature of the client's business transactions, form of accounting records, stated qualifications of the accounting personnel, accounting basis to be used, and form and content of the financial statements.

6. Consider the necessity to perform any other accounting services to enable compilation of the financial statements.

7. If there is any indication that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory, obtain additional or revised information.

8. Draft and read the financial statements and consider whether:
   a. The financial statements are appropriate in form.
   b. The financial statements are free of obvious mathematical or clerical error.

9. Include a legend on each page of the financial statements and supplementary data indicating the restricted nature of the presentation.

10. Document any other procedures performed or unusual problems and their resolution.

11. Determine that all required forms and checklists have been completed.

12. Determine that all questions, exceptions, or notes, if any, posed during the work have been followed up and resolved, and review notes and "to do" lists have been removed from the work papers.
Appendix G: Compilation of Financial Statements Flowchart

During the initial development of Statement on Standards for Accounting and Review Services (SSARS) No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1*, Compilation and Review of Financial Statements (AICPA, *Professional Standards*, vol. 2, AR sec. 100), the members of AICPA’s Accounting and Review Services Committee (ARSC) designed a flowchart to help guide their discussion about the proposed changes in SSARS No. 1. That flowchart, which appeared in SSARS No. 8, is also useful in explaining how compilation engagements may change due to the issuance of SSARS No. 8. We are including it in this appendix with the addition of explanatory notes.
Will you submit financial statements?

SSARS No. 1 is not applicable.

Are any exemptions from SSARS No. 1 applicable?

Follow the applicable guidance:
- Personal financial statements included in a personal financial plan; see SSARS No. 6, Reporting on Personal Financial Statements Included in Written Personal Financial Plans (AICPA, Professional Standards, vol. 2, AR sec. 600).
- Litigation support services; see Interpretation No. 20, “Applicability of Statements on Standards for Accounting and Review Services in Litigation Services,” of SSARS No. 1.

Were you engaged to compile and report on financial statements?

Establish an understanding with the client and follow performance requirements in SSARS No. 1, AR sections 100.07-.10, as follows:
- Possess or obtain a general understanding of the industry.
- Possess or obtain a general understanding of the client's business.
- Take certain actions if the information supplied by the client appears to be incorrect, incomplete, or otherwise unsatisfactory.
- Read the compiled financial statements and consider whether they appear to be appropriate in form and free of obvious material errors.

AND follow reporting requirements as set out in AR sections 100.11-.19.

Do you reasonably expect a third party to use the compiled financial statements?

Establish an understanding with the client and follow performance requirements in SSARS No. 1, AR section 100.07-10:
- Possess or obtain a general understanding of the industry.
- Possess or obtain a general understanding of the client's business.
- Take certain actions if the information supplied by the client appears to be incorrect, incomplete, or otherwise unsatisfactory.
- Read the compiled financial statements and consider whether they appear to be appropriate in form and free of obvious material errors.

AND follow one of the communication requirements in AR sections 100.20-.23:
- Issue a compilation report, or
- Document understanding with client with a written engagement letter, preferably signed by management.
Notes to the Flowchart

1 Submission of financial statements—Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

2 Compilation of financial statements—Presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements.

3 Third parties—All parties except for management who are generally knowledgeable and understand the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.

4 The engagement letter should include the following matters:
   - A description of the nature and limitations of the services to be performed.
   - A statement that a compilation is limited to presenting in the form of financial statements information that is the representation of management.
   - A statement that the financial statements have not been audited or reviewed.
   - A statement that no opinion or any other form of assurance on the financial statements will be provided.
   - An acknowledgment that management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.
   - An acknowledgment of management’s representation and agreement that the financial statements will not be used by third parties.
   - A statement that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts.

The engagement letter should also include the following additional matters, if applicable:
   - A statement that material departures from generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting (OCBOA) may exist and the effects of those departures on the financial statements may not be disclosed.
   - A statement that substantially all disclosures (and the statement of comprehensive income and statement of cash flows, if applicable) required by GAAP or OCBOA may be omitted.
   - A statement that the accountant is not independent.
   - A reference to any supplementary information that may be included.
Appendix H: Text of Statement on Standards for Accounting and Review Services No. 8*

Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements

1. This amendment provides communication and performance requirements for unaudited financial statements submitted to a client that are not expected to be used by a third party. The performance and communication requirements for such engagements would be subject to the Statement on Standards for Accounting and Review Services (SSARS) 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100), as amended. This Statement does not preclude an accountant from reporting in compliance with SSARS 1 in such engagements.

.01 This Statement sets forth the performance and communication requirements when an accountant submits unaudited financial statements of a nonpublic entity to his or her client or third parties. The accountant should not submit unaudited financial statements of a nonpublic entity to his or her client or a third party unless, as a minimum, he or she complies with the provisions of this Statement applicable to a compilation engagement.

a. Compilation of financial statements. If the accountant performs a compilation, a communication to management is required. The type of communication depends on the following.

1. If the accountant is engaged to report on compiled financial statements or submits financial statements to a client that are or reasonably might be expected to be used by a third party, see SSARS 1, AR sections 100.11-.19 for reporting requirements.

2. If the accountant submits financial statements to a client that are not reasonably expected to be used by a third party, see SSARS 1, AR sections 100.20-.23 for required communications to management.

* This appendix reprints the text only of Statement on Standards for Accounting and Review Services (SSARS) No. 8, Amendment to Statement on Standards for Accounting and Review Services No. 1, Compilation and Review of Financial Statements (AICPA, Professional Standards, vol. 2, AR sec. 100). Appendix A (AR sec. 100.53) and Appendix D (AR sec. 100.56) of SSARS No. 8 are included separately, in Appendixes G and C of this Practice Aid.

1 See appendix A, “Compilation of Financial Statements,” for a flowchart describing the requirements of Statements on Standards for Accounting and Review Services (SSARS) for a compilation engagement.
In deciding whether the financial statements are, or reasonably might be, expected to be used by a third party, the accountant may rely on management's representation without further inquiry, unless information comes to his or her attention that contradicts management's representation.

In each of the above circumstances, the performance requirements in AR sections 100.05 and 100.07-.10 apply.

b. Review of financial statements. If the accountant performs a review, see AR sections 100.05 and 100.24-.39 for performance and reporting requirements.

.02 If the accountant performs more than one service (for example, a compilation and an audit), the accountant should issue the report that is appropriate for the highest level of service rendered.3

.03 An accountant should not consent to the use of his or her name in a document or written communication containing unaudited financial statements of a nonpublic entity unless (a) the accountant has compiled or reviewed the financial statements and a report accompanies them or (b) the financial statements are accompanied by an indication that the accountant has not compiled or reviewed the financial statements and that the accountant assumes no responsibility for them. If an accountant becomes aware that his or her name has been used improperly in any client-prepared document containing unaudited financial statements, the accountant should advise the client that the use of his or her name is inappropriate and should consider what other actions might be appropriate, including consultation with his or her attorney.

Definitions

.04 Certain terms are defined for purposes of this Statement as follows.

Submission of financial statements. Presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software.

2 Statements on Auditing Standards (SASs) provide guidance to the accountant who performs services in connection with the unaudited financial statements of a public entity. However, if a public entity does not have its annual financial statements audited, an accountant may review the entity's annual or interim financial statements in accordance with SSARSs as permitted by footnote 4 of SAS No. 26, Association With Financial Statements (AICPA, Professional Standards, vol. 1, AU sec. 504.05).

3 SSARS 3, Compilation Reports on Financial Statements Included in Certain Prescribed Forms (AICPA, Professional Standards, vol. 2, AR sec. 300), permits an accountant who has reviewed the financial statements of a nonpublic entity to issue a compilation report on financial statements for the same period that are included in a prescribed form that calls for departure from generally accepted accounting principles (GAAP).
Third party. All parties except for members of management who are knowledgeable about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.⁴

Nonpublic entity. Any entity other than (a) one 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) one 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). (See SSARS No. 2, Reporting on Comparative Financial Statements [AICPA, Professional Standards, vol. 2, AR sec. 200].)

Financial statement. A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles (GAAP)⁵ or a comprehensive basis of accounting other than GAAP.⁶ Financial forecasts, projections and similar presentations,⁷ and financial presentations included in tax returns are not financial statements for purposes of this Statement. The following financial presentations are examples of financial statements:⁸

- Balance sheet
- Statement of income
- Statement of comprehensive income
- Statement of retained earnings

---

⁴ The accountant may wish to specify those members of management. See appendix D, “Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter.”

⁵ The definition of generally accepted accounting principles (GAAP) and the hierarchy of established accounting principles presented in SAS No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles in the Independent Auditor’s Report (AICPA, Professional Standards, vol. 1, AU sec. 411) is also applicable to compilations and reviews of financial statements performed under SSARSs.

⁶ The term comprehensive basis of accounting other than generally accepted accounting principles is defined in SAS No. 62, Special Reports (AICPA, Professional Standards, vol. 1, AU sec. 623.04). Hereafter, reference to GAAP in this Statement includes, where applicable, an other comprehensive basis of accounting (OCBOA). SAS No. 62, AU section 623.09 and .10, provides guidance on evaluating the adequacy of disclosure in financial statements prepared in conformity with OCBOA.

⁷ Statement on Standards for Attestation Engagements No. 1, Financial Forecasts and Projections (AICPA, Professional Standards, vol. 2, AT sec. 200), as well as the AICPA Guide for Prospective Financial Information, provide guidance on preparing and reporting on financial forecasts, projections, and similar presentations.

⁸ SAS No. 62, AU section 623.07 provides guidance with respect to suitable titles for financial statements that are prepared in conformity with OCBOA other than GAAP.
• Statement of cash flows
• Statement of changes in owners’ equity
• Statement of assets and liabilities (with or without owners’ equity accounts)
• Statement of revenue and expenses
• Statement of financial position
• Statement of activities
• Summary of operations
• Statement of operations by product lines
• Statement of cash receipts and disbursements

A financial statement may be, for example, that of a corporation, a consolidated group of corporations, a combined group of affiliated entities, a not-for-profit organization, a governmental entity, an estate or trust, a partnership, a proprietorship, a segment of any of these, or an individual. The method of preparation (for example, manual or computer preparation) is not relevant to the definition of a financial statement.

Compilation of financial statements. Presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements. (The accountant might consider it necessary to perform other accounting services to compile the financial statements. See AR section 100.08.)

Review of financial statements. Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements for them to be in conformity with GAAP or, if applicable, with an other comprehensive basis of accounting (OCBOA). (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him or her to perform a review. See AR section 100.30.)

The objective of a review differs significantly from the objective of a compilation. The inquiry and analytical procedures performed in a review should provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. No expression of assurance is contemplated in a compilation.

9 AR sections 100.16-.18 of this Statement provide guidance to the accountant engaged to compile financial statements that omit substantially all the disclosures required by GAAP or OCBOA.
The objective of a review also differs significantly from the objective of an audit of financial statements in accordance with generally accepted auditing standards (GAAS). The objective of an audit is to provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole. A review does not provide a basis for the expression of such an opinion because a review does not contemplate obtaining an understanding of internal control or assessing control risk, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter through inspection, observation, or confirmation; and certain other procedures ordinarily performed during an audit. A review may bring to the accountant's attention significant matters affecting the financial statements, but it does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit.

**Understanding With the Entity**

.05 The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. However, if the engagement is to compile financial statements not expected to be used by a third party, a written communication is required. (See AR sections 100.20-.21.) The understanding should include a description of the nature and limitations of the services to be performed and a description of the report, if a report is to be issued. The understanding should also provide (a) that the engagement cannot be relied upon to disclose errors, fraud or illegal acts and (b) that the accountant will inform the appropriate level of management\(^\text{10}\) of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential. Examples of engagement letters are presented in appendixes C, D, and E.

**Compilation of Financial Statements**

.06 AR sections 100.07-.10 are applicable to a compilation of financial statements, whenever the accountant—

- Is engaged to report on compiled financial statements.
- Submits financial statements to a client that are or reasonably might be expected to be used by a third party.
- Submits financial statements to a client that are not expected to be used by a third party.

\(^{10}\) When a fraud or illegal act involves senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or the board of directors.
Compilation Performance Requirements

.07 The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him or her to compile financial statements that are appropriate in form for an entity operating in that industry. This standard does not prevent an accountant from accepting a compilation 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, or individuals knowledgeable about the industry.

.08 To compile financial statements, the accountant should possess a general understanding of the nature of the entity’s business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. The accountant ordinarily obtains knowledge of these matters through experience with the entity or inquiry of the entity’s personnel. On the basis of that understanding, the accountant should consider whether it will be necessary to perform other accounting services, such as assist in adjusting the books of account or consultation on accounting matters, when he or she compiles financial statements.

.09 The 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 made inquiries or performed other procedures. The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. In such circumstances, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement. (However, see AR sections 100.16–.18 for guidance when management elects to omit substantially all the disclosures required by GAAP and see AR sections 100.40–.42 for the accountant’s reporting responsibilities when he or she is aware of other departures from GAAP.)

.10 Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term error refers to mistakes in the compilation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure.

11 For purposes of this Statement, the term industry includes governmental and not-for-profit activities.
Reporting on the Financial Statements

.11 When the accountant is engaged to report on compiled financial statements or submits financial statements that are reasonably expected to be used by a third party, the financial statements should be accompanied by a report stating that—

a. A compilation has been performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

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

c. The financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them.

Any other procedures that the accountant might have performed before or during the compilation engagement should not be described in the report.

.12 The date of completion of the compilation should be used as the date of the accountant’s report.

.13 Each page of the financial statements compiled by the accountant should include a reference, such as “See Accountant’s Compilation Report.”

.14 The following form of standard report is appropriate for a compilation:

I (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, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

.15 An accountant may be asked to issue a compilation report on one financial statement, such as a balance sheet, and not on other related financial statements, such as the statements of income, retained earnings, and cash flows. This Statement does not preclude the accountant from doing so. Also, an accountant may be asked to compile financial statements included in a prescribed form that calls for departure from GAAP. SSARS No. 3, Compilation Reports on Financial Statements Included in Certain Prescribed Forms (AICPA, Professional Standards, vol. 2, AR sec. 300), provides additional guidance, including an alternative form of standard report, applicable to such compilation engagements.
Reporting on Financial Statements That Omit Substantially All Disclosures

.16 An entity may request an accountant to compile financial statements that omit substantially all the disclosures required by GAAP, including disclosures that might appear in the body of the financial statements. (As previously noted, reference to GAAP in this Statement includes, where applicable, OCBOA.) The accountant may compile such financial statements provided the omission of substantially all disclosures is clearly indicated in the report and is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When the entity wishes to include disclosures about only a few matters in the form of notes to such financial statements, such disclosures should be labeled “Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included.”

.17 Notwithstanding the above, if financial statements compiled in conformity with a comprehensive basis of accounting other than GAAP do not include disclosure of the basis of accounting used, the basis should be disclosed in the accountant’s report.

.18 When financial statements that the accountant has compiled omit substantially all disclosures, the following form of standard report is appropriate.

I (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, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all the disclosures (and the statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures and statements 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, these financial statements are not designed for those who are not informed about such matters.

See AR sections 100.40-.42 for the accountant’s responsibilities when he or she is aware of other departures from GAAP. However, see SSARS 3, Compilation Reports on Financial Statements Included in Certain Prescribed Forms (AICPA, Professional Standards, vol. 2, AR sec. 300), for guidance when such financial statements are included in a prescribed form and the prescribed form or related instructions do not request the disclosures required by GAAP.

If the statement of comprehensive income or cash flows is omitted, the first and third paragraphs of the report should be modified accordingly.
Reporting When the Accountant Is Not Independent

.19 An accountant is not precluded from issuing a report with respect to a compilation of financial statements for an entity with respect to which the accountant is not independent. If the accountant is not independent, he or she should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, the following should be included as the last paragraph of the report:

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

Accountant’s Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party

.20 When an accountant submits unaudited financial statements to his or her client that are not expected to be used by a third party, he or she should either—

- Issue a compilation report in accordance with the reporting requirements discussed in AR sections 100.11–.19.
- Document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements. (Appendix D contains “Compilation of Financial Statements Not Intended for Third Party Use—Illustrative Engagement Letter.”)

.21 The documentation of the understanding should include the following descriptions or statements:

- The nature and limitations of the services to be performed.
- A compilation is limited to presenting in the form of financial statements information that is the representation of management.
- The financial statements will not be audited or reviewed.
- No opinion or any other form of assurance on the financial statements will be provided.
- Management has knowledge about the nature of the procedures applied and the basis of accounting and assumptions used in the preparation of the financial statements.

In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct.
• Acknowledgment of management’s representation and agreement that the financial statements are not to be used by third parties.

• The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.

The documentation of the understanding should also address the following additional matters if applicable:

• Material departures from GAAP or OCBOA may exist and the effects of those departures, if any, on the financial statements may not be disclosed.

• Substantially all disclosures (and the statement of cash flows, if applicable) required by GAAP or OCBOA may be omitted.

• Lack of independence.

• Refer to supplementary information.

Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. If the accountant believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

.22 The accountant should include a reference on each page of the financial statements restricting their use such as “Restricted for Management’s Use Only,” or “Solely for the information and use by the management of [name of entity] and not intended to be and should not be used by any other party.”

.23 If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and request that the client have the statements returned. If the client does not comply with this request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third-party use, preferably in consultation with his or her attorney.

2. This Statement will be in effect for financial statements submitted after December 31, 2000.