1978

Compilation and review of financial statements

American Institute of Certified Public Accountants. Accounting and Review Services Committee

Compilation and Review of Financial Statements

1. This statement defines the *compilation of financial statements* and the *review of financial statements* of a nonpublic entity and provides guidance to accountants concerning the standards and procedures applicable to such engagements.[1] The accountant is required to issue a report whenever he completes a compilation or review of the financial statements of a nonpublic entity in compliance with the provisions of this statement. The accountant should not issue any report on the unaudited financial statements of a nonpublic entity or submit such financial statements to his client or others unless he complies with the provisions of this statement.

2. The statement recognizes that accountants may perform other accounting services either in connection with the compilation or review of financial statements or as a separate service. The statement distinguishes such services from a compilation and from a review. The statement does not establish standards or procedures for such other accounting services, examples of which follow:

a. Preparing a working trial balance.
b. Assisting in adjusting the books of account.
c. Consulting on accounting, tax, and similar matters.
d. Preparing tax returns.
e. Providing various manual or automated bookkeeping or data processing services unless the output is in the form of financial statements.
f. Processing financial data for clients of other accounting firms.

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1. Statements on auditing standards provide guidance to the accountant who performs services in connection with the unaudited financial statements of a public entity.

General

3. This statement provides guidance considered necessary to enable the accountant to comply with the general standards of the profession set forth in rule 201 of the rules of conduct of the AICPA Code of Professional Ethics (see Appendix E) in the context of a compilation engagement or a review engagement and establishes additional standards deemed appropriate for such engagements.

Definitions

4. Certain terms are defined for purposes of this statement as follows:

Nonpublic entity. Any entity other than one (*a*) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, or (*b*) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market.[2]

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 or a comprehensive basis of accounting other than generally accepted accounting principles.[3] Financial forecasts, projections and similar presentations, 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:[4]

- Balance sheet.
- Statement of income.
- Statement of retained earnings.
- Statement of changes in financial position.

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2. The provisions of this statement are applicable to separately issued financial statements of a subsidiary, corporate joint venture, or other investee that is nonpublic as that term is defined above.

3. The term *comprehensive basis of accounting other than generally accepted accounting principles* is defined in SAS no. 14, paragraph 4. Hereafter, reference to generally accepted accounting principles in this statement includes, where applicable, another comprehensive basis of accounting.

4. SAS no. 14, paragraph 7, provides guidance with respect to suitable titles for financial statements that are prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles.

- Statement of changes in owners' equity.
- Statement of assets and liabilities (with or without owners' equity accounts).
- Statement of revenue and expenses.
- 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 government unit, 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[5] 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 enable him to compile financial statements. See paragraph 11.)

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 in order for them to be in conformity with generally accepted accounting principles or, if applicable, with another comprehensive basis of accounting. (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him to perform a review. See paragraph 28.)

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.

The objective of a review also differs significantly from the objective of an examination of financial statements in accordance

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5. Paragraphs 19–21 of this statement provide guidance to the accountant engaged to compile financial statements that omit substantially all of the disclosures required by generally accepted accounting principles or another comprehensive basis of accounting.

with generally accepted auditing standards. 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 a study and evaluation of internal accounting control, 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.

The Accountant's Reporting Obligation

5. Management, shareholders, credit grantors, and others who use financial statements should be able to readily identify the degree of responsibility, if any, the accountant is taking with respect to such financial statements. A written report is recognized by users of financial statements as the vehicle by which an accountant indicates that responsibility. Accordingly, whenever an accountant compiles or reviews financial statements of a nonpublic entity, he should issue a report prepared in accordance with the applicable standards in this statement. However, when the accountant performs more than one service (for example, a compilation and an audit), he should issue the report that is appropriate for the highest level of service rendered.

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

7. The accountant should not submit unaudited financial statements of a nonpublic entity to his client or others unless, as a minimum, he complies with the provisions of this statement applicable to a compilation engagement. This precludes the accountant from merely typing or reproducing financial statements as an accommodation to his client.

Understanding With the Entity

8. The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report the accountant expects to render. The understanding should also provide (*a*) that the engagement cannot be relied upon to disclose errors, irregularities, or illegal acts and (*b*) that the accountant will inform the entity of any such matters that come to his attention. Examples of engagement letters are presented in Appendixes B and C.

Compilation of Financial Statements

9. Paragraphs 10–22 provide additional guidance applicable to a compilation of financial statements.

10. 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 to compile financial statements that are appropriate in form for an entity operating in that industry.[6] 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 him a responsibility to obtain the required level of knowledge. He 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.

11. 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

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6. For purposes of this statement, the term *industry* includes not-for-profit activities.

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 assistance in adjusting the books of account or consultation on accounting matters, when he compiles financial statements.

12. 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 (see paragraphs 2 and 11). 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 for the purpose of compiling financial statements. (However, see paragraphs 19–21 for guidance when management elects to omit substantially all of the disclosures required by generally accepted accounting principles.) 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 compilation engagement. (See paragraphs 39–41 for the accountant's responsibilities when he is aware of departures from generally accepted accounting principles.)

13. Before issuing his report, the accountant should read the compiled 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.

Reporting on the Financial Statements

14. Financial statements compiled without audit or review by an accountant should be accompanied by a report stating that—

a. A compilation has been performed.

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 his report.

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

16. Each page of the financial statements compiled by the accountant should include a reference such as "See Accountant's Compilation Report."

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

> The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).
>
> 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.

18. 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 changes in financial position. This statement does not preclude the accountant from doing so.

Reporting on Financial Statements That Omit Substantially All Disclosures

19. An entity may request an accountant to compile financial statements that omit substantially all of the disclosures required by generally accepted accounting principles, including disclosures that might appear in the body of the financial statements.[7] (As previously noted, reference to generally accepted accounting principles in this statement includes, where applicable, another comprehensive basis of accounting.) The accountant may compile such financial statements provided the omission of substantially all disclosures is clearly indicated in his report and is not, to his knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements. When the entity

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7. See paragraphs 39–41 for the accountant's responsibilities when he is aware of other departures from generally accepted accounting principles.

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."

20. Notwithstanding the above, if financial statements compiled in conformity with a comprehensive basis of accounting other than generally accepted accounting principles do not include disclosure of the basis of accounting used, the basis should be disclosed in the accountant's report.

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

> The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).
>
> 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.
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> Management has elected to omit substantially all of the disclosures (and the statement of changes in financial position) required by generally accepted accounting principles.[8] 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 changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

Reporting When the Accountant Is Not Independent

22. An accountant is not precluded from issuing a report with respect to his compilation of financial statements for an entity with respect to which he is not independent.[9] If the accountant is

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8. If the statement of changes in financial position is omitted, the first and third paragraphs of the report should be modified accordingly.

9. In making a judgment about whether he is independent, the accountant should be guided by the AICPA Code of Professional Ethics. For example, the accountant should be aware that interpretation 101.3 under rule 101 of the rules of conduct indicates that independence is not necessarily impaired when an accountant provides manual or automated bookkeeping or data processing services to a client.

not independent, he should specifically disclose the lack of independence. However, the reason for the lack of independence should not be described. When the accountant is not independent, he should include the following as the last paragraph of his report:

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

Review of Financial Statements

23. Paragraphs 24–38 provide additional guidance applicable to a review of financial statements.

24. The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates and an understanding of the entity's business[10] that will provide him, through the performance of inquiry and analytical procedures, with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (As previously noted, reference to generally accepted accounting principles in this statement includes, where applicable, another comprehensive basis of accounting.)

25. The requirement that the accountant possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates does not prevent an accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. He 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.

26. The accountant's understanding of the entity's business should include a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses. This would ordinarily involve a general knowledge of the entity's production, distribution, and compensation methods, types of products and services, operating locations,

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10. For purposes of this statement, the term *business* includes not-for-profit entities.

and material transactions with related parties. An accountant's understanding of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel.

27. The accountant's inquiry and analytical procedures should ordinarily consist of the following:

a. Inquiries concerning the entity's accounting principles and practices and the methods followed in applying them (see Appendix A).

b. Inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements (see Appendix A).

c. Analytical procedures designed to identify relationships and individual items that appear to be unusual. For the purposes of this statement, analytical procedures consist of (1) comparison of the financial statements with statements for comparable prior period(s), (2) comparison of the financial statements with anticipated results, if available (for example, budgets and forecasts), and (3) study of the relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience. In applying these procedures, the accountant should consider the types of matters that required accounting adjustments in preceding periods. Examples of relationships of elements in financial statements that would be expected to conform to a predictable pattern may be the relationships between changes in sales and changes in accounts receivable and expense accounts that ordinarily fluctuate with sales, and between changes in property, plant, and equipment and changes in depreciation expense and other accounts that may be affected, such as maintenance and repairs.

d. Inquiries concerning actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.

e. Reading the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with generally accepted accounting principles.

f. Obtaining reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees.[11]

g. Inquiries of persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied, (2) changes in the entity's business activities or accounting principles and practices, (3) matters as to which questions have arisen in the course of applying the foregoing procedures, and (4) events subsequent to the date of the financial statements that would have a material effect on the financial statements.

28. Knowledge acquired in the performance of audits of the entity's financial statements, compilation of the financial statements, or other accounting services may result in modification of the review procedures described in the preceding paragraph. However, such modification would not reduce the degree of responsibility the accountant assumes with respect to the financial statements he has reviewed.

29. A review does not contemplate a study and evaluation of internal accounting control, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. However, if the accountant becomes aware that information coming to his attention is incorrect, incomplete, or otherwise unsatisfactory, he should perform the additional procedures he deems necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (See paragraph 36 for guidance when an accountant is unable to complete a review and paragraphs 39–41 for the accountant's responsibilities when he is aware of departures from generally accepted accounting principles.)

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11. The financial statements of the reporting entity ordinarily include an accounting for all significant components, such as unconsolidated subsidiaries and investees. If other accountants are engaged to audit or review the financial statements of such components, the accountant will require reports from other accountants as a basis, in part, for his report on his review of the financial statements of the reporting entity. The accountant may decide to make reference to the work of other accountants in his review report on the financial statements. If such reference is made, the report should indicate the magnitude of the portion of the financial statements audited or reviewed by the other accountants.

30. Although it is not possible to specify the form or content of the working papers that an accountant should prepare in connection with a review of financial statements because of the different circumstances of individual engagements, the accountant's working papers should describe—

a. The matters covered in the accountant's inquiry and analytical procedures.

b. Unusual matters that the accountant considered during the performance of the review, including their disposition.

31. The accountant may wish to obtain a representation letter from the owner, manager, or chief executive officer, and, if appropriate, the chief financial officer. An example of a representation letter is presented in Appendix D.

Reporting on the Financial Statements

32. Financial statements reviewed by an accountant should be accompanied by a report stating that—

a. A review was performed in accordance with standards established by the American Institute of Certified Public Accountants.

b. All information included in the financial statements is the representation of the management (owners) of the entity.

c. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data.

d. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, no such opinion is expressed.

e. The accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles, other than those modifications, if any, indicated in his report.

Any other procedures that the accountant might have performed before or during the review engagement, including those performed in connection with a compilation of the financial statements, should not be described in his report.

33. The date of completion of the accountant's inquiry and analytical procedures should be used as the date of his report.

34. Each page of the financial statements reviewed by the accountant should include a reference such as "See Accountant's Review Report."

35. The following form of standard report is appropriate for a review.[12]

> I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.
>
> A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.
>
> Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

36. When an accountant is unable to perform the inquiry and analytical procedures he considers necessary to achieve the limited assurance contemplated by a review, his review will be incomplete. A review that is incomplete is not an adequate basis for issuing a review report. In such a situation, the accountant should consider whether the circumstances resulting in an incomplete review also preclude him from issuing a compilation report on the entity's financial statements. In making that judgment, the accountant should consider matters similar to those discussed in paragraphs 44–49.

37. An accountant may be asked to issue a review 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 changes in financial position. He may do so if the scope of his inquiry and analytical procedures has not been restricted.

38. An accountant is precluded from issuing a review report on the financial statements of an entity with respect to which he is not

12. See paragraphs 39–41 for the accountant's responsibilities when he is aware of departures from generally accepted accounting principles.

independent.[13] If the accountant is not independent, he may issue a compilation report provided he complies with the compilation standards.

Departures From Generally Accepted Accounting Principles

39. An accountant who is engaged to compile or review financial statements may become aware of a departure from generally accepted accounting principles (which include adequate disclosure) that is material to the financial statements. (As noted previously, reference in this statement to generally accepted accounting principles includes, where applicable, another comprehensive basis of accounting.) Paragraphs 19–21 provide guidance to the accountant when the departure relates to the omission of substantially all disclosures in the financial statements he has compiled. In all other circumstances, if the financial statements are not revised, the accountant should consider whether modification of his standard report is adequate to disclose the departure.

40. If the accountant concludes that modification of his standard report is appropriate,[14] the departure should be disclosed in a separate paragraph of his report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided the accountant states in his report that such determination has not been made. Examples of compilation and review reports that disclose departures from generally accepted accounting principles follow.

Compilation Report

> The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by me (us).

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13. See footnote 9.

14. Normally, neither an uncertainty nor an inconsistency in the application of accounting principles would cause the accountant to modify the standard report provided the financial statements appropriately disclose such matters. Nothing in this statement, however, is intended to preclude an accountant from emphasizing in a separate paragraph of his report a matter regarding the financial statements.

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. However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph(s).

(Separate paragraph)

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by $500,000.

or

A statement of changes in financial position for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.[15]

Review Report

I (we) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter(s) described in the following paragraph(s), I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

15. If a statement of changes in financial position is not presented, the first paragraph of the compilation or review report should be modified accordingly.

(Separate paragraph)

As disclosed in note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and changes in financial position have not been determined.

or

As disclosed in note X to the financial statements, the company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the company does not appear to have reasonable justification for making a change as required by Opinion no. 20 of the Accounting Principles Board.

41. If the accountant believes that modification of his standard report is not adequate to indicate the deficiencies in the financial statements taken as a whole, he should withdraw from the compilation or review engagement and provide no further services with respect to those financial statements. The accountant may wish to consult with his legal counsel in those circumstances.

Subsequent Discovery of Facts Existing at Date of Report

42. Subsequent to the date of the report on the financial statements that the accountant has compiled or reviewed, he may become aware that facts may have existed at that date which might have caused him to believe that information supplied by the entity was incorrect, incomplete, or otherwise unsatisfactory had he then been aware of such facts. In such circumstances, the accountant may wish to consider the guidance in section 561 of Statement on Auditing Standards no. 1 in determining an appropriate course of action, giving due consideration to the different objectives of compilation, review, and audit engagements. Because of the legal implications involved in actions contemplated under section 561 of SAS no. 1, the accountant should consider consulting with his attorney.

Supplementary Information

43. When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility, if any, he is taking with respect to such information. When the accountant has reviewed the basic financial statements, this may be accomplished by an explanation in his review report, or in a separate report on the other data, that the review has been made primarily for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles, and either

a. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or

b. The other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

When the accountant has compiled both the basic financial statements and other data presented only for supplementary analysis purposes, his compilation report should also include the other data.

Change in Engagement From Audit to Review or Compilation

44. An accountant who has been engaged to examine the financial statements of a nonpublic entity in accordance with generally accepted auditing standards may, before the completion of his examination, be requested to change the engagement to a review or compilation of financial statements. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit, a misunderstanding as to the nature of an audit or the alternative review or compilation services originally available, or a restriction on the scope of the examination, whether imposed by the client or caused by circumstances.

45. Before an accountant who was engaged to perform an examination in accordance with generally accepted auditing standards agrees to change the engagement to a review or compilation, at least the following should be considered:

a. The reason given for the client's request, particularly the implications of a restriction on the scope of the examination, whether imposed by the client or by circumstances.

b. The additional audit effort required to complete the examination.

c. The estimated additional cost to complete the examination.

46. A change in circumstances that affects the entity's requirement for an audit or a misunderstanding concerning the nature of an audit or the alternative review or compilation services originally available would ordinarily be considered a reasonable basis for requesting a change in the engagement.

47. In considering the implications of a restriction on the scope of the examination, the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. Nevertheless, when the accountant has been prohibited by the client from corresponding with the entity's legal counsel, or when management (owners) has refused to sign a client representation letter, the accountant ordinarily would be precluded from issuing a review or compilation report on the financial statements.

48. In all circumstances, if the auditing procedures are substantially complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement.

49. If the accountant concludes, based upon his professional judgment, that there is reasonable justification to change the engagement and if he complies with the standards applicable to the changed engagement, he should issue an appropriate review or compilation report. The report should *not* include reference to (*a*) the original engagement, (*b*) any auditing procedures that may have been performed, or (*c*) scope limitations that resulted in the changed engagement.

Comparative Financial Statements

50. When prior-period financial statements are presented with current-period financial statements, the accountant should issue an appropriate report covering each period presented.[16]

Effective Date

51. This statement will be effective for compilations and reviews of financial statements for periods ending on or after July 1, 1979.

16. Reports on comparative financial statements will be the subject of a separate statement.

APPENDIX A

Review of Financial Statements — Illustrative Inquiries

The inquiries to be made in a review of financial statements are a matter of the accountant's judgment. In determining his inquiries, an accountant may consider (*a*) the nature and materiality of the items, (*b*) the likelihood of misstatement, (*c*) knowledge obtained during current and previous engagements, (*d*) the stated qualifications of the entity's accounting personnel, (*e*) the extent to which a particular item is affected by management's judgment, and (*f*) inadequacies in the entity's underlying financial data. The following list of inquiries is for illustrative purposes only. The inquiries do not necessarily apply to every engagement, nor are they meant to be all-inclusive. This list is not intended to serve as a program or checklist in the conduct of a review; rather it describes the general areas in which inquiries might be made. For example, the accountant may feel it is necessary to make several inquiries to answer one of the questions listed below, such as item 3(*a*).

1. General
   - *a.* What are the procedures for recording, classifying, and summarizing transactions (relates to each section discussed below)?
   - *b.* Do the general ledger control accounts agree with subsidiary records (for example, receivables, inventories, investments, property and equipment, accounts payable, accrued expenses, noncurrent liabilities)?
   - *c.* Have accounting principles been applied on a consistent basis?
2. Cash
   - *a.* Have bank balances been reconciled with book balances?
   - *b.* Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made where necessary?
   - *c.* Has a proper cutoff of cash transactions been made?
   - *d.* Are there any restrictions on the availability of cash balances?
   - *e.* Have cash funds been counted and reconciled with control accounts?
3. Receivables
   - *a.* Has an adequate allowance been made for doubtful accounts?
   - *b.* Have receivables considered uncollectible been written off?
   - *c.* If appropriate, has interest been reflected?
   - *d.* Has a proper cutoff of sales transactions been made?
   - *e.* Are there any receivables from employees and related parties?
   - *f.* Are any receivables pledged, discounted, or factored?
   - *g.* Have receivables been properly classified between current and noncurrent?

4. Inventories
   a. Have inventories been physically counted? If not, how have inventories been determined?
   b. Have general ledger control accounts been adjusted to agree with physical inventories?
   c. If physical inventories are taken at a date other than the balance sheet date, what procedures were used to record changes in inventory between the date of the physical inventory and the balance sheet date?
   d. Were consignments in or out considered in taking physical inventories?
   e. What is the basis of valuation?
   f. Does inventory cost include material, labor, and overhead where applicable?
   g. Have write-downs for obsolescence or cost in excess of net realizable value been made?
   h. Have proper cutoffs of purchases, goods in transit, and returned goods been made?
   i. Are there any inventory encumbrances?
5. Prepaid Expenses
   a. What is the nature of the amounts included in prepaid expenses?
   b. How are these amounts amortized?
6. Investments, Including Loans, Mortgages, and Intercorporate Investments
   a. Have gains and losses on disposal been reflected?
   b. Has investment income been reflected?
   c. Has appropriate consideration been given to the classification of investments between current and noncurrent, and the difference between the cost and market value of investments?
   d. Have consolidation or equity accounting requirements been considered?
   e. What is the basis of valuation of marketable equity securities?
   f. Are investments unencumbered?
7. Property and Equipment
   a. Have gains or losses on disposal of property or equipment been reflected?
   b. What are the criteria for capitalization of property and equipment? Have such criteria been applied during the fiscal period?
   c. Does the repairs and maintenance account only include items of an expense nature?
   d. Are property and equipment stated at cost?
   e. What are the depreciation methods and rates? Are they appropriate and consistent?
   f. Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?

   g. Does the entity have material lease agreements? Have they been properly reflected?
   h. Is any property or equipment mortgaged or otherwise encumbered?

8. Other Assets
   a. What is the nature of the amounts included in other assets?
   b. Do these assets represent costs that will benefit future periods? What is the amortization policy? Is it appropriate?
   c. Have other assets been properly classified between current and noncurrent?
   d. Are any of these assets mortgaged or otherwise encumbered?

9. Accounts and Notes Payable and Accrued Liabilities
   a. Have all significant payables been reflected?
   b. Are all bank and other short-term liabilities properly classified?
   c. Have all significant accruals, such as payroll, interest, and provisions for pension and profit-sharing plans been reflected?
   d. Are there any collateralized liabilities?
   e. Are there any payables to employees and related parties?

10. Long-Term Liabilities
   a. What are the terms and other provisions of long-term liability agreements?
   b. Have liabilities been properly classified between current and noncurrent?
   c. Has interest expense been reflected?
   d. Has there been compliance with restrictive covenants of loan agreements?
   e. Are any long-term liabilities collateralized or subordinated?

11. Income and Other Taxes
   a. Has provision been made for current and prior-year federal income taxes payable?
   b. Have any assessments or reassessments been received? Are there tax examinations in process?
   c. Are there timing differences? If so, have deferred taxes been reflected?
   d. Has provision been made for state and local income, franchise, sales, and other taxes payable?

12. Other Liabilities, Contingencies, and Commitments
   a. What is the nature of the amounts included in other liabilities?
   b. Have other liabilities been properly classified between current and noncurrent?
   c. Are there any contingent liabilities, such as discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims? Are there any unasserted potential claims?
   d. Are there any material contractual obligations for construction or purchase of real property and equipment and any commitments or options to purchase or sell company securities?

13. Equity
    a. What is the nature of any changes in equity accounts?
    b. What classes of capital stock have been authorized?
    c. What is the par or stated value of the various classes of stock?
    d. Do amounts of outstanding shares of capital stock agree with subsidiary records?
    e. Have capital stock preferences, if any, been disclosed?
    f. Have stock options been granted?
    g. Has the entity made any acquisitions of its own capital stock?
    h. Are there any restrictions on retained earnings or other capital?
14. Revenue and Expenses
    a. Are revenues from the sale of major products and services recognized in the appropriate period?
    b. Are purchases and expenses recognized in the appropriate period and properly classified?
    c. Do the financial statements include discontinued operations or items that might be considered extraordinary?
15. Other
    a. Are there any events that occurred after the end of the fiscal period that have a significant effect on the financial statements?
    b. Have actions taken at stockholder, board of directors, or comparable meetings that affect the financial statements been reflected?
    c. Have there been any material transactions between related parties?
    d. Are there any material uncertainties? Is there any change in the status of material uncertainties previously disclosed?

APPENDIX B

Compilation of Financial Statements — Illustrative Engagement Letter

(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 changes in financial position of XYZ Company for the year 19XX. 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:

> The accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended have been compiled by us.
>
> 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 changes in financial position. 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, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

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)

Acknowledge:
XYZ Company

____

President

____

Date

* 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 C

Review of Financial Statements— Illustrative Engagement Letter

(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 review the balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them. Our report on the financial statements is presently expected to read as follows:

> We have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and changes in financial position for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of XYZ Company.
>
> A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.
>
> Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, we are unable to complete our review 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, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

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)

Acknowledge:
XYZ Company

____
President

____
Date

APPENDIX D

Review of Financial Statements—Illustrative Representation Letter

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. Because a review does not contemplate tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, among other things, the accountant may consider it advisable to obtain a written representation from his client to confirm the oral representations made to him. The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of his review engagement, that other matters should be specifically included in the letter and that some of the representations included in the illustrative letter are not necessary.

(Date of Accountant's Report)

(To the Accountant)

In connection with your review of the (identification of financial statements) of (name of client) as of (date) and for the (period of review) for

* 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. . . ."

the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and changes in financial position of (name of client) in conformity with generally accepted accounting principles. In that connection, we specifically confirm that—
   a. The company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
   b. There have been no changes during the (period reviewed) in the company's accounting principles and practices.
   c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
   d. There are no material transactions that have not been properly reflected in the financial statements.
   e. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
   f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
   g. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
   h. There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
   i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
   j. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.

2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies, as applicable) that may affect the financial statements.

3. We have responded fully to all inquiries made to us by you during your review.

____
(Name of Owner or Chief Executive Officer and Title)

____
(Name of Chief Financial Officer and Title, where applicable)

APPENDIX E

Rule 201 of the Rules of Conduct of the AICPA Code of Professional Ethics

*Rule 201—General Standards.** A member shall comply with the following general standards as interpreted by bodies designated by Council, and must justify any departures therefrom.

A. Professional competence. A member shall undertake only those engagements which he or his firm can reasonably expect to complete with professional competence.

B. Due professional care. A member shall exercise due professional care in the performance of an engagement.

C. Planning and supervision. A member shall adequately plan and supervise an engagement.

D. Sufficient relevant data. A member shall obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to an engagement.

E. Forecasts. A member shall not permit his name to be used in conjunction with any forecast of future transactions in a manner which may lead to the belief that the member vouches for the achievability of the forecast.

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* The general standards of the profession are applicable to the performance of engagements in all major areas of accounting practice. However, the general standard of the profession entitled "Forecasts" is not applicable to compilation and review engagements because the scope of this statement, *Compilation and Review of Financial Statements,* does not include financial forecasts, projections, and similar presentations.

The statement entitled Compilation and Review of Financial Statements *was adopted unanimously by the fifteen members of the committee, of whom five, Messrs. Goble, Gutberlet, Miller, Nelson, and Rossel assented with qualifications.*

Messrs. Goble, Nelson, and Rossel approve the issuance of this statement but qualify their assent because they believe paragraph 31 should require the accountant to obtain a representation letter from the client in a review engagement. They believe this requirement is necessary because a review contemplates accepting client representations without an obligation to perform any corroborative procedures. They believe obtaining a representation letter reduces the possibility of misunderstanding concerning the client representations included in the financial statements.

Mr. Goble also believes that paragraph 19, which provides guidance on reporting on compiled financial statements that omit substantially all of the disclosures required by generally accepted accounting principles, should state that (1) material events or transactions occurring subsequent to the balance sheet date but prior to the issuance of the financial statements and accountant's report and (2) material contingencies that come to the accountant's attention are not contemplated among the disclosures that may be omitted.

Mr. Rossel also believes paragraphs 39, 40, and 41 contain insufficient guidance concerning the factors an accountant should consider in deciding whether to modify his standard report or to withdraw from the engagement due to departures from generally accepted accounting principles. He believes, as a minimum, such guidance should be similar to that contained in section 509.16 of Statement on Auditing Standards no. 1, which relates to the factors to be considered in an audit engagement in deciding whether the effects of a departure from generally accepted accounting principles are sufficiently material to require either a qualified or an adverse opinion.

Mr. Gutberlet assents to the publication of this statement because it is a significant step in the right direction. However, he qualifies his assent because he believes that the statement does not sufficiently recognize the realities of professional practice. He accepts, without reservation, the concepts of a compilation and of a review of financial statements. He believes that this statement properly distinguishes the accounting services an accountant performs when he compiles or reviews financial statements from auditing services. However, he also believes that the practice of public accountancy includes engagements to prepare financial statements from information maintained or developed by an accountant, including information necessary for footnote disclosure, reflecting the policies, practices, or other decisions of the owners and/or management of a client, with or without undertaking to express some form of assurance. This accounting service, which usually includes assistance in adjusting the books of account, is frequently rendered as an adjunct to another accounting service, that is, the preparation of tax returns. Therefore, Mr. Gutberlet believes that the statement should have directly addressed the broad service of preparation of financial statements, including all of the other services that are essential for financial statement presentation.

Mr. Gutberlet also qualifies his assent with respect to the guidance provided in paragraph 14 on the form of report that should accompany compiled financial statements because he believes it is inconsistent with the standards established in paragraphs 12 and 13 and with the objective of a compilation of financial statements as described in paragraph 4. He believes that paragraph 14 should require that the accountant's report state that a compilation has been performed in accordance with standards established by the American Institute of Certified Public Accountants and that the objective of a compilation is limited to presenting in the form of financial statements information that is the representation of owners and/or management of an entity without undertaking to express any form of assurance on the financial statements. He also believes that paragraph 14 should explicitly provide that the accountant's report should disclose any departures from generally accepted accounting principles, or, if applicable, any other comprehensive basis of accounting, of which the accountant becomes aware.

Mr. Gutberlet qualifies his assent with respect to the standards and procedures for performing a review of financial statements. He believes that the level of the accountant's understanding of an entity's business is too narrowly circumscribed by paragraph 24. He believes that the accountant's understanding of the entity's business must be such that the accountant is able to design and perform inquiry and analytical and any other procedures considered necessary under the circumstances (including development of sufficient footnote disclosures) that will provide him with a reasonable basis for expressing limited assurance. Mr. Gutberlet also believes that paragraph 30 should require the accountant to document (*a*) the fact that the engagement had been planned and that the work of any assistants had been supervised and reviewed, and (*b*) the accountant's understanding of the entity's business, including a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses.

Mr. Gutberlet qualifies his assent with respect to the guidance provided in paragraphs 36 and 44 through 49. Paragraph 36 permits the accountant, in certain circumstances, to issue a compilation report when he is unable to achieve the limited assurance contemplated in a review. Paragraphs 44 through 49 permit the accountant, in certain circumstances, to issue a review report or a compilation report when he had originally been engaged to perform an audit. In Mr. Gutberlet's opinion, the most important criterion to be applied in determining the type of report an accountant should issue is the terms and objectives of the engagement at the time an understanding (which he presumes precedes commencement of field work) with a client is reached. He concludes that a disclaimer of opinion (as described in SAS no. 2, paragraphs 10 through 12) is appropriate when the accountant is unable to perform an examination or a review sufficient in scope to enable him to form an opinion or express limited assurance, as applicable, on or with respect to the financial statements.

Mr. Gutberlet also qualifies his assent with respect to the guidance provided in paragraphs 39 through 41 concerning the possibility of withdrawal from a compilation or review engagement because, in his view, it is inadequate and potentially misleading. He believes that a reasonably informed reader of the statement will conclude that withdrawal from an engagement is mandated when the departures from generally accepted accounting principles or another comprehensive basis of accounting are such that an adverse opinion might be required in an audit environment when, in fact, this is not necessarily the case. He believes that the statement should explicitly provide for compilation and review reports which state that "the accompanying financial statements are not fairly presented in accordance with generally accepted accounting principles."

Mr. Miller approves the issuance of this statement, but qualifies his assent because he believes paragraph 38 should allow a nonindependent accountant to issue a review report that does not include an expression of limited assurance. A nonindependent accountant who performs the inquiries and analytical procedures contemplated by a review engagement is required by the statement to issue a compilation report. Mr. Miller believes that the accountant is thereby required to describe incorrectly the nature of the service he has provided. Mr. Gutberlet joins Mr. Miller in this qualification.

Mr. Miller also believes paragraph 22 should allow the accountant to disclose the reasons for his lack of independence. He believes that this information is an important factor in the user's evaluation of financial statements compiled by the nonindependent accountant, and, accordingly, the usefulness of the financial statements is substantially impaired by the user's lack of knowledge of the reasons for the accountant's lack of independence.

Accounting and Review Services Committee (1977–1978)

Note: *Statements on Standards for Accounting and Review Services are issued by the AICPA Accounting and Review Services Committee, the senior technical committee of the Institute designated to issue pronouncements in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity. Members should be aware that they may be called upon to justify departures from this statement.*