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Proposed statement on auditing standards : Public reporting on a limited review of interim financial information;Public reporting on a limited review of interim financial information

American Institute of Certified Public Accountants. Auditing Standards Executive Committee

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EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS: PUBLIC REPORTING ON A LIMITED REVIEW OF INTERIM FINANCIAL INFORMATION

FEBRUARY 6, 1976

Issued by the Auditing Standards Executive Committee of the
American Institute of Certified Public Accountants
For Comment From Persons Interested in Auditing and Reporting

Comments should be received by March 10, 1976, and addressed to
Auditing Standards Division, File Ref. No. 3070
AICPA, 1211 Avenue of the Americas, New York, N.Y. 10036



American Institute of Certified Public Accountants

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February 6, 1976

To Practice Offices of CPA Firms; Members of Council; Technical Committee Chairmen; State Society and Chapter Presidents, Directors and Committee Chairmen; Organizations Concerned With Regulatory, Supervisory or Other Public Disclosure of Financial Activities; Persons Who Have Requested Copies:

This is an exposure draft of a Statement on Auditing Standards on public reporting on limited reviews of interim financial information. The exposure period is unavoidably short so that the Committee can furnish guidance to CPAs who may be asked to report on limited reviews early in 1976. We recognize that this is traditionally a very busy time for CPAs but seek to assure that this exposure draft nevertheless will receive appropriate attention.

In developing this exposure draft the Auditing Standards Executive Committee considered the provisions of the SEC's Accounting Series Release (ASR) No. 177, which permits a registrant to disclose in quarterly financial filings whether a limited review of interim data was performed by a CPA. A registrant that makes the disclosure must also state whether adjustments and disclosures proposed by the CPA as a result of the limited review were reflected in the related financial information.

Most of the members of the Executive Committee believe that clients making these representations to the SEC cannot be prohibited from making the same representations in reports to stockholders. Further, clients that are not registrants may choose to have certain data subjected to a limited review on a timely basis. Consequently, it is likely that some companies will include representations concerning limited reviews of financial information in quarterly stockholders' reports beginning with the first calendar quarter of 1976.

With that background, the key decision reflected in this draft is that the public is better served if a CPA's report is included with the data subjected to a limited review than if a client makes a representation about the results of a CPA's review. That decision will result in a significant change from current practice concerning reports on unaudited financial information. The draft provides for a form of report that includes an expression of limited assurance based on the performance of specified procedures established in Statement on Auditing Standards No. 10, "Limited Review of Interim Financial Information." This report is based on the concept that users will be able to distinguish among various types of assurance providing the limits of the assurance are disclosed in the CPA's report and the underlying procedures meet professional standards.

Comments on the exposure draft should be sent as soon as possible but must be received prior to March 10 so that the Executive Committee will have the benefit of your views in completing this project. The Executive Committee is particularly interested in views concerning the advisability of adopting the accountant's report illustrated in this draft. The Committee will furnish comments received on this issue to the Accounting and Review Services Subcommittee for their use in reconsidering the reporting problems arising when a CPA is associated with unaudited financial information.

Sincerely,

A handwritten signature in cursive script that reads "Kenneth P. Johnson".

Kenneth P. Johnson, Chairman
Auditing Standards Division

A handwritten signature in cursive script that reads "John F. Mullarkey".

John F. Mullarkey, Director
Auditing Standards Division

PROPOSED STATEMENT ON AUDITING STANDARDS

PUBLIC REPORTING ON A LIMITED REVIEW OF INTERIM FINANCIAL INFORMATION¹

1. This Statement applies to an accountant's limited review of interim financial information, whether presented in complete or summarized form, that is included in documents issued to stockholders and others or forms filed with regulatory agencies. The interim financial information may be presented separately or in a note to audited financial statements. It provides guidance for the accountant reporting publicly on a limited review of interim financial information.²

PUBLIC REPORTING ON A TIMELY LIMITED REVIEW

2. An accountant may consent to the use of his name and the inclusion of his report in a written communication setting forth interim financial information if he has made a limited review of such information as specified in SAS No. 10 on a timely basis (prior to initial issuance). If restrictions on the scope of a limited review preclude completion of such a review, the accountant should not consent to the use of his name.³ Restrictions on the scope of a limited review may be imposed by a client or caused by circumstances, such as the timing of the accountant's

work, an inadequacy in the accounting records, or a material weakness in internal accounting control procedures.

Form of Accountant's Report

3. The accountant's report accompanying interim financial information subjected to a limited review on a timely basis should consist of (a) a statement that the limited review was performed in accordance with the standards for such reviews, (b) an identification of the interim financial information reviewed, (c) a statement as to whether effect was given in the interim financial information to adjustments or disclosures proposed by the accountant, (d) a statement that a limited review would not necessarily disclose adjustments or disclosures that should be given effect to in the interim financial information, and (e) a statement that an examination in accordance with generally accepted auditing standards was not performed and a disclaimer of opinion. The report may be addressed to the company, its board of directors, or its stockholders. Generally, the report should be dated as of the date of the completion

of the limited review.⁴ In addition, each page of the interim financial information should be clearly identified as unaudited.

4. An example of such a report follows:

We have performed a limited review, in accordance with standards for such reviews promulgated by the American Institute of Certified Public Accountants, of (describe the information or statements subjected to such review) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended.⁵ While the accompanying (information or statements) include(s) any adjustments or disclosures proposed by us as a result of our limited review, had we performed procedures in addition to those contemplated by a limited review other matters might have come to our attention that would have caused us to propose adjustments or disclosures. Because our limited review did not constitute an examination in accordance with generally accepted auditing standards, we express no opinion on the (information or statements) referred to above.

Circumstances Requiring Modification of the Accountant's Report

5. The circumstances that require modification of the account-

¹ This Statement amends SAS No. 1, section 516.09, by the addition of the following sentence: An accountant may also refer to the standards for a limited review of interim financial information when reporting on such a review and state whether effect was given in the interim financial information to adjustments or disclosures proposed by the accountant (see SAS No. 10 and X.)

² The nature, timing, and extent of procedures that constitute a limited review and the nature of the report that may be issued to the board of directors are contained in SAS No. 10, "Limited Review of Interim Financial Information."

³ However, see paragraph 10 concerning reporting considerations when the scope of a limited review has been restricted. Also, when the accountant is unable to complete a limited review because of a scope limitation, he should consider the implications of that limitation with respect to the interim financial information issued by the client on a timely basis. In those circumstances, the accountant should refer to paragraphs 15, 18, and 23 of SAS No. 10 for guidance on the appropriate course of action.

⁴ Other reporting issues involved in the dating or concerning subsequent events are similar to those encountered in an examination of financial statements (see section 530 of SAS No. 1).

⁵ If interim financial information of a prior period is presented with that of the current period and the accountant has performed a limited review of that information, he should report on his review of the prior period. An example of the first sentence of such a report would be: "We have performed . . . of ABC Company and consolidated subsidiaries as of September 30, 19X1 and 19XX and for the three-month and nine-month periods then ended." If the accountant has not performed a limited review of the prior-period information, his report should so indicate.

ant's report on a limited review differ in some respects from those that would ordinarily preclude the expression of an unqualified opinion on audited financial statements because the report is not an expression of opinion. For example, an uncertainty affecting the interim financial information would not cause the accountant to modify his report unless he knew that disclosure concerning the uncertainty was inadequate. Modifications of the accountant's report that might be required include reference to (a) failure to give effect to proposed adjustments or disclosures, (b) the report of another accountant, and (c) a change in accounting method.

6. Proposed Adjustments. If the accountant has proposed adjustments because of departures from generally accepted accounting principles and effect has not been given to the adjustments in the accompanying interim financial information, he should modify his report. The modification should describe the nature of the departure and, if possible, state its effect on the information. An example of a modification to the accountant's report referring to a departure from generally accepted accounting principles follows:

The following proposed adjustment was not given effect to in the accompanying (information or statements) referred to above. Based on the information furnished to us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations, which should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized at September 30, 19X1, property would be increased by \$....., and long-term debt by \$....., and net income and earnings per share would be increased (decreased) by \$....., \$....., and \$....., \$....., respectively, for the three and nine months then ended. While the accompanying (information or statements) includes all other adjustments or disclosures proposed by us, had we performed procedures in addition to those contemplated

by a limited review other matters might have come to our attention that would have caused us to propose adjustments or disclosures.

7. Proposed Disclosures. The information the accountant will conclude is necessary for adequate disclosure will be influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of APB Opinion No. 28, paragraph 30, are considerably less extensive than those necessary for annual financial statements that present financial position, results of operations and changes in financial position in conformity with generally accepted accounting principles.⁶ Also, for example, if the interim financial information is presented in conformity with the requirements of Form 10-Q (see paragraph 11) the disclosures considered necessary would be less extensive than those necessary for annual financial statements, but could be more extensive than the minimum requirements of Opinion No. 28. If the accountant has proposed the inclusion of information that is necessary for adequate disclosure and it is not included in the interim financial information, he should modify his report. The modification should describe the departure from generally accepted accounting principles and include the necessary information.

8. Report of Another Accountant. The accountant may use and make reference to the report of another accountant on a limited review of interim financial information as a basis, in part, for his own report. This reference indicates a division of responsibility

⁶ APB Opinion No. 28, paragraph 32, states: "... there is a presumption that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by generally accepted accounting principles and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context."

for performance of the limited review.⁷ An example of such a modification is as follows:

With regard to the ADE subsidiary whose total assets and revenues constitute 20 percent and 22 percent, respectively, of the related consolidated totals, we read the report of other accountants on their limited review of the interim financial information of such subsidiary. While the accompanying (information or statements) include(s) any adjustments or disclosures proposed by us, or the other accountants referred to above, as a result of the limited review, had we performed . . .

9. Change in Accounting Method. Consideration of changes in accounting method based on information supplied by management is an integral part of a limited review of interim financial information (see SAS No. 10, paragraphs 16-17). When the accountant becomes aware of a change in an accounting method in performing a limited review, he should modify his report to identify the change and to indicate whether he concurs with the new accounting method. An example of such a modification follows:

The Company has changed its method of accounting for long-term construction contracts as described in Note X to the (information or statements). On the basis of management's explanation, we concur with the new accounting method.

Client's Representation Concerning a Limited Review

10. The accountant may be requested to make a limited review of interim financial information on a timely basis to permit the client to include a representation to that effect in documents issued to stockholders. The client might also elect to make such representation

⁷ SAS No. 10, paragraph 10(e), footnote 3, states: "When an accountant acts as principal auditor . . . and makes use of the work or reports of other auditors in the course of the annual examination . . ., he ordinarily will be in a similar position in connection with a limited review. . . ."

in other documents issued to third parties on a timely basis. If the client represents in such a written communication setting forth interim financial information that the accountant has made a limited review, the accountant should insist that his report be included. If the client will not agree to include the accountant's report or if the accountant has been unable to complete the review (see paragraph 2), the accountant should insist that the client's representation be deleted. If the client does not comply, the accountant should advise management that he does not consent to the use of his name and should consider what other action might be appropriate.⁸

11. The accountant may also be requested to make a limited review of interim financial information on a timely basis to permit the client to include a representation to that effect in Form 10-Q. The procedures for a limited review set forth in paragraphs 8 through 18, inclusive, of SAS No. 10 constitute the appropriate professional standards and procedures for an accountant's review of interim financial information for that purpose. When these procedures are performed, the client may represent that the accountant has made a limited review of the interim financial information. If such representation is made, the client must state whether effect was given to all adjustments or disclosures pro-

⁸In considering what actions, if any, may be appropriate in these circumstances, the accountant should consult his legal counsel.

posed by the accountant and the accountant should insist that his report be included (see SAS No. 10, Appendix, paragraph 2).

**INTERIM FINANCIAL
INFORMATION INCLUDED IN
A NOTE TO AUDITED
FINANCIAL STATEMENTS**

12. Certain companies are required by Regulation S-X of the Securities and Exchange Commission to include in audited financial statements a note containing selected interim financial information (see SAS No. 10, Appendix, paragraph 1). Other companies may also elect to include similar information in their audited financial statements. Since this selected interim information is not required for a fair presentation of financial position, results of operations and changes in financial position in conformity with generally accepted accounting principles, the auditor ordinarily need not modify his report on audited financial statements to make reference to his limited review or to the selected interim financial information.

13. The auditor's report should be expanded, however, if the scope of the limited review was restricted (see paragraph 2) or if the interim financial information appears to him not to be presented in conformity with generally accepted accounting principles. For example, expansion of an auditor's report to refer to the restricted scope might be made by the inclusion of the following separate paragraph:

Note X, "Unaudited Interim Financial Information," contains information that we did not audit and, accordingly, we do not express an opinion on that information. We attempted to perform certain procedures with respect to that information as specified by Statement on Auditing Standards No. 10, "Limited Review of Interim Financial Information." The procedures are of a limited nature and require that the Company have developed and maintained a system for preparing interim financial information to enable the review to be performed. The system used by the Company does not provide an adequate basis to enable us to complete this (the required) review.

14. The auditor's report on annual financial statements should also be expanded when interim financial information that has been subjected to the limited review procedures specified in SAS No. 10 and included in a note to the financial statements is not appropriately identified as unaudited. Appropriate identification of the note to the annual financial statements would ordinarily include disclosure that the interim financial information, although unaudited, was subjected to limited review procedures. Such disclosure might be accomplished by including a statement parallel to the client's representations permitted on Form 10-Q (see paragraph 11).⁹

⁹Such a disclosure in annual audited financial statements does not require the inclusion of the accountant's report on a limited review.