2000

Compilation and review alert - 2000/01

American Institute of Certified Public Accountants. Auditing Standards Division

COMPILATION AND REVIEW ALERT

Compilation and Review Alert—2000/01

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

AICPA

COMPILATION AND REVIEW ALERT

Compilation and Review Alert—2000/01

American Institute of Certified Public Accountants

AICPA

Notice to Readers

The *Compilation and Review Alert—2000/01* is intended to provide CPAs with an update on recent practice issues and professional standards that affect compilation and review engagements. The document has not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA.

Written by J. Russell Madray, CPA

Leslye Givarz
Technical Manager
Accounting and Auditing Publications

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 Alert. Special thanks from our team to J. Russell Madray who developed and wrote this Alert. In addition, we appreciate the efforts of the following reviewers who contributed their valuable ideas and feedback: Alan Winters, CPA, and Mimi Blanco-Best, CPA.

1 2 3 4 5 6 7 8 9 0 AAG 0 9 8 7 6 5 4 3 2 1 0

In This Year's Alert…

Table of Contents

Introduction

What is the authority of the Compilation and Review Alert—2000/01*?*

The *Compilation and Review Alert—2000/01* is a nonauthoritative practice aid designed to help CPAs plan and perform their 2000 and 2001 compilation and review engagements. It clarifies certain existing Statements on Standards for Accounting and Review Services (SSARS), suggests ways of implementing those standards in special circumstances, points out pitfalls that frequently occur in compilation and review engagements, and addresses emerging practice issues.

Recent Changes to SSARS 1

What recent changes did the Accounting and Review Services Committee (ARSC) make to clarify the applicability of SSARS 1? What is the current status of "management-use only" financial statements?

During 2000, Accounting and Review Services Committee (ARSC) completed work that will make fundamental changes to the way in which accountants view the compilation engagement. These changes mark the first major revision to SSARS in over twenty years. During the exposure period (which ran from December 31, 1999, to June 9, 2000), ARSC received approximately eighty comment letters, and incorporated a number of the suggestions into the final document.

In making this change, the ARSC decided to take a new approach to addressing the many perceived problems with SSARS. In past proposals (for example, the 1995 proposal, *Assembly of Financial Statements for Internal Use Only*), ARSC addressed the problems by attempting to exempt certain financial statements (internal-use, computer-generated, and so on) from the requirements of SSARS 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100). The majority of the profession opposed most of these proposals.

In this change, the ARSC actually rewrote SSARS 1 rather than simply trying to exempt certain financial statement engagements. The result is SSARS 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1* (AICPA, *Professional Standards*, vol. 2, AR sec. 100). SSARS 8 retains the best of what SSARS 1 has always offered. In fact, it does not change professional standards for review engagements; nor does it change the performance standards (that is, the procedures you perform when you compile financial statements) for compilation engagements. Rather, SSARS 8 adds new options to make SSARS 1 more flexible and to allow you to use your professional judgment in dealing with the client. The following two things have changed:

- The definition of *submission of financial statements* (which triggers the application of SSARS 1)
- The addition of communication options in certain circumstances

By modifying the definition of submission, ARSC believes that the majority of the applicability problems (deciding when SSARS 1 applies and when it does not, especially when performing various accounting and bookkeeping services) would be solved. Submission of financial statements is now defined as "presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software." This is a substantial change from the previous definition that referred to "generating financial statements or modifying client-prepared financial statements." You will still have to use your professional judgment to determine whether you have prepared a financial statement. Yet, ARSC believes that this modification is the best way to address today's technological environment, while still maintaining a minimum level of service on financial statements that are *prepared* by the accountant and *presented* to the client.

The second change involves communication options. The compilation report has long been the vehicle by which you communicate, among other things, your degree of responsibility for the financial statements to the financial statement user. ARSC believes, however, that there should be other ways of communicating the same information in certain limited circumstances, namely, in an engagement in which the financial statements are *not expected to be used by third parties*. In this kind of engagement, you can now compile the financial statements and choose between the following communication options when communicating the results of your engagement: (1) the standard compilation report and (2) an engagement letter. The engagement letter (the new option) contains much of the same information as found in a standard compilation report, but simply presents it in a different format. See appendix A, "Compilation of Financial Statements," for an overview of the changes and appendix B, "Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter," for a sample engagement letter.

The changes are effective for financial statements submitted after December 31, 2000.

> **Help Desk:** The AICPA has published a Compilation and Review Alert to assist practitioners in implementing these changes related to SSARS into their practice. You can obtain the AICPA Compilation and Review Alert, *Practical Guidance for Implementing SSARS 8, How to Understand and Apply the Amendments to SSARS 1, Compilation and Review of Financial Statements* (Product No. 022274kk) by calling the AICPA Order Department at (888) 777-7077.

Executive Summary—Recent Changes to SSARS 1

- The ARSC issued SSARS 8 in 2000 to make major changes in SSARS 1.
- The following are two major changes to SSARS 1 brought about by SSARS 8:
  - A change in the definition of *submission of financial statements*
  - A new communication option for a management-use only compilation engagement
- SSARS 8 is effective for financial statements submitted after December 31, 2000.
- The AICPA has issued a Compilation and Review Alert that provides guidance for implementing SSARS 8 (Product No. 022274kk).

Current Practice Issues

Applicability of SSARS 1

With the changes to SSARS 1, how do I now determine whether SSARS 1 applies?

SSARS 1 is applicable whenever you submit unaudited financial statements of a nonpublic entity to your client or third parties. As mentioned in the previous section of this Alert, SSARS 8 modifies the definition of *submission*. Submission of financial statements is now defined as "presenting to a client or third parties financial statements that the accountant has prepared either manually or through the use of computer software."

Note that the following two actions 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 1, therefore, is not applicable.

SSARS 8 does not define the term *prepared*. Rather, you must use your professional judgment to determine whether you have prepared a financial statement. In making this judgment, you should consider the difference between the performance of mere bookkeeping services (for example, adjustments, corrections, or accruals) and preparation of financial statements. In order to prepare financial statements you must use your knowledge, education, and experience to create financial statements that would not have existed otherwise. In other words, if the financial statements prepared by your client's bookkeeper are pretty good to begin with, and all you do is "tweak a couple of things," then you probably have not prepared the financial statements. On the other hand, if the client gives you an unadjusted trial balance and you make all of the adjustments necessary to convert the information into financial statements, then you probably have prepared the financial statements.

The term *presenting* is also not defined by SSARS 8. Again, you will have to use your professional judgment to determine whether you have presented financial statements to a client. Obviously, physically presenting printed financial statements would meet the definition used here. Consider other situations, especially those involving electronic presentation (for example, via email) carefully.

The following table may be helpful in determining whether you have submitted financial statements.

Scenario	*Submission of Financial Statements?*	*Reasoning*
1. Using client information, the CPA prepares financial statements in the CPA's office for use in preparing a corporate income tax return, and the financial statements are not given to the client.	No	The financial statements are not presented to the client, and the information contained in a tax return is not considered a financial statement.
2. Same scenario as item 1, except that a copy of the financial statements is given to the client, along with the income tax return.	Yes	The financial statements are prepared by the accountant and presented to the client.
3. Same scenario as item 1, except that a copy of the adjusting journal entries and trial balance is given to the client, along with the income tax return.	No	A trial balance is not a financial statement.
4. At a client's office, the CPA makes material adjustments to the client's accounting database, prints the adjusted financial statements, and takes the financial statements with him or her.	No	The accountant is providing bookkeeping services, but the accountant is not preparing financial statements. Material modifications no longer constitute a submission of financial statements. In addition, the accountant did not present the financial statements to the client.*

continued

Scenario	*Submission of Financial Statements?*	*Reasoning*
5. Same scenario as item 4, except that the CPA also prints a copy of the financial statements and presents them to the client.	No	The accountant is providing bookkeeping services, but the accountant is not preparing financial statements. Material modifications no longer constitute a submission of financial statements. Although the financial statements were presented to the client, they were not prepared by the accountant.*
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.	No	The accountant is providing bookkeeping services, but the accountant is not preparing financial statements. Material modifications no longer constitute a submission of financial statements.*
7. The CPA accesses the client's accounting database by modem and makes material modifications to the accounting database.	No	The accountant is providing bookkeeping services, but the accountant is not preparing financial statements. Material modifications no longer constitute a submission of financial statements.*

* Note that each of these scenarios requires a certain amount of professional judgment. If you believe that, in making these material adjustments, you have, in fact, prepared financial statements (by using your knowledge, experience, and education) 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 1.

Interaction of SSARS 1 to 8

Do all of the standards apply to every compilation and review engagement? How do the eight SSARS interact?

Synopsis of SSARS Standards

SSARS 1 was issued in 1978. Since that time, seven additional standards have been issued. The following is a brief synopsis of each of the standards.

- SSARS 1, *Compilation and Review of Financial Statements*, issued in December 1978, replaced the former unaudited engagement standards contained in Statement on Auditing Standards (SAS) No.1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec.516). SSARS 1 provides guidance to CPAs concerning the standards and procedures applicable to engagements to compile or review financial statements. It does not establish standards or procedures for other services (for example, tax return or bookkeeping services).
- SSARS 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200), issued in October 1979, applies to reports on any comparative financial statements that include current period compiled or reviewed financial statements of an entity that is nonpublic as of the current period. Otherwise, SASs would apply.
- SSARS 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*, vol. 2, AR sec. 300) issued in December 1981, amends SSARS 1 and 2 to provide for an alternative form of standard compilation report on prescribed forms that call for departures from generally accepted accounting principles (GAAP). It applies to any standard, preprinted form designed or adopted by the body to which it is submitted (for example, a bank).
- SSARS 4, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*, vol. 2, AR sec. 400), issued in December 1981, provides guidance to a successor who decides to communicate with a predecessor. It does not require communication; however, it requires a predecessor to respond if authorized by the client.
- SSARS 5, *Reporting on Compiled Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 500), was issued in July 1982 and deleted in November 1992 by the issuance of SSARS 7. All of the former SSARS 5 requirements are now included in SSARS 1, 2, and 3.

- SSARS 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AICPA, *Professional Standards*, vol. 2, AR sec. 600), issued in September 1986, provides an optional exemption from SSARS 1 if—
  - You establish an understanding with the client, preferably in writing, that the financial statements will be used solely to assist the client and the client's advisers to develop the client's personal financial goals and objectives, and will not be used to obtain credit or for any other purposes.
  - Nothing comes to your attention during the engagement that causes you to believe that the financial statements will be used to obtain credit or for other purposes.
- SSARS 7, *Omnibus Statement on Standards for Accounting and Review Services—1992* (AICPA, *Professional Standards*, vol. 2, AR sec. 700), issued in November 1992, contains a number of technical amendments.
- SSARS 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1, amends SSARS 1*, to change the definition of *submission of financial statements* and to allow accountants to submit management-use only financial statements without issuing a compilation report. Instead, it requires accountants to document the understanding with the client in an engagement letter, preferably signed by management.

Application of SSARS

Every standard does not apply to every engagement. SSARS 1 (as amended by SSARS 7 and SSARS 8) generally applies to any engagement in which you submit financial statements to a client or third parties (compilation or review engagement). SSARS 2 applies to any engagement to report on comparative financial statements.

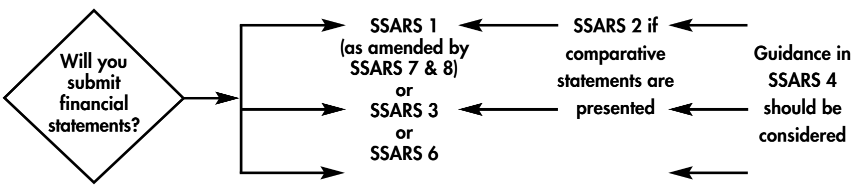
SSARS 3 and SSARS 6 are considered optional exemptions from SSARS 1 (SSARS 1 applies unless the conditions in SSARS 3 or SSARS 6 are met). SSARS 3 is considered a partial exemption and applies if the engagement is to compile financial statements contained in certain prescribed forms. The performance standards in SSARS 1 apply, but the reporting standards are replaced by the special reporting requirements of SSARS 3. SSARS 6 is considered a complete exemption from SSARS 1. If the SSARS 6 conditions are met, SSARS 1 does not apply.

SSARS 4 contains recommended communication guidance for any compilation or review engagement in which a change of accountants has occurred.

Interaction of SSARS

Exhibit 1, "Interaction of SSARS," illustrates this interaction between the standards.

Exhibit 1—Interaction of SSARS



Independence and Client Services

What does SSARS say about independence? How do I know whether I am independent? Is other guidance available?

SSARS 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. The lack of independence is noted either in the compilation report or in the engagement letter if the financial statements are restricted to management's use and if they are not intended to be used by third parties. The following sentence is added 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*, the Interpretations of Rule 101, and the related independence rulings of the AICPA *Code of Professional*

Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 100). You should also consult the independence rules of (1) your state board of accountancy, (2) your state CPA society, and (3) any applicable regulatory agency.

Independence is a complex area; it is easy to define, but difficult to apply. Consequently, the AICPA developed a new user-friendly Audit Risk Alert that is a guide to understanding the subject of independence, *The ABCs of Independence Alert* (Product No. 022271kk).

Engagement Letters

What are the SSARS requirements for engagement letters? Do engagement letters have to be signed by management? Does the "understanding with the client" have to be in writing?

SSARS 1, as amended, states the following.

> 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 third parties, a written communication is required.

Since there are now two kinds of compilation engagements (financial statements compiled for management's use only and financial statements compiled for general use), the engagement letter requirements depend upon the kind of engagement.

For reviewed financial statements or for financial statements compiled for general use, it is preferable that the understanding be in writing. That understanding should include the following:

1. A description of the nature and limitations of the services to be performed
2. A description of the report to be rendered
3. A statement that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts
4. 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

For financial statements compiled for management's use only, a *written* engagement letter is *required*. SSARS 1, as amended, states that it is preferable that management sign this engagement letter. The engagement letter in this kind of compilation not only documents the understanding with the entity, but also documents management's representation and agreement that the financial statements are not to be used by third parties. The engagement letter also documents 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. Although not required, it is advisable to have management sign this engagement letter in order to reduce the possibility of a misunderstanding. This engagement letter should include the following:

1. A description of the nature and limitations of the services to be provided
2. A statement that a compilation is limited to presenting in the form of financial statements information that is the representation of management
3. A statement that the financial statements will not be audited or reviewed
4. A statement that no opinion or any other form of assurance on the financial statements will be provided
5. 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
6. An acknowledgment of management's representation and agreement that the financial statements are not to be used by third parties
7. A statement that the engagement cannot be relied upon to disclose errors, fraud, or illegal acts

The engagement letter for management-use only financial statements should also include the following additional matters, if applicable:

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

You can find an illustrative engagement letter for financial statements compiled for management's use only in Appendix B of this Alert. Examples of other engagement letters appear in the appendixes of SSARS 1.

Legal Liability in Compilation and Review Engagements

What is my legal liability to third parties in a compilation or review engagement?

Although this Alert does not purport to provide legal advice to accountants, there are several legal issues that bear on compiled or reviewed financial statements. Accounting and assurance services have traditionally carried litigation risk for CPAs. Courts use the following four standards to judge which nonclients are owed a duty by accountants:

- Privity
- Near privity
- Restatement rule (also known as *known users*)
- Reasonable foreseeablility[1]

1. Pacini, et al., "SysTrust and Third-Party Risk," *Journal of Accountancy* (AICPA, August 2000).

Privity

Privity is the most restrictive standard and carries the least likelihood of liability for the accountant. Privity requires a contractual relationship between an accountant and a third party for the third party to be able to sue the accountant. Currently, only Pennsylvania and Virginia follow a strict privity rule. A nonclient would have no legal right to sue an accountant for a compilation or review engagement under a strict privity rule.

Near Privity

In order to prevail under *near privity*, the plaintiff must be an intended third-party beneficiary of the contract between the accountant and the client. In 1985, the New York Court of Appeals set forth a legal test containing the following three elements that must be satisfied for a nonclient to be able to sue an accountant under the near privity standard.

- The accountant must have known that his or her work product was to be used for a particular purpose.
- A known party or parties were intended to be able to rely on the accountant's work product.
- Some conduct must have linked the accountant to the relying party.

Twelve states follow the near privity rule, although there are a number of variations among them: Arkansas, Idaho, Illinois, Kansas, Louisiana, Michigan, Montana, Nebraska, New Jersey, New York, Utah, and Wyoming.

Restatement Rule

Under the *restatement rule* (established by a federal court in 1968), an accountant who audits or prepares financial information for a client owes a duty not only to that client but also to any other person or one of a group of persons whom the accountant or client intends the information to benefit, if both of the following conditions are met.

- That person or entity justifiably relies on the information in a transaction that the accountant or client intends the information to influence.

- Such reliance results in a pecuniary loss for the person or group.

The major difference between the near privity rule and the restatement rule is that the latter does not require the practitioner to know the identity of specific parties, only that they be members of a limited group known to the practitioner.

Twenty-one states apply the restatement rule: Alabama, Alaska, Arizona, California, Colorado, Connecticut, Florida, Georgia, Hawaii, Iowa, Massachusetts, Minnesota, Missouri, New Hampshire, North Carolina, Ohio, South Carolina, Tennessee, Texas, Washington, and West Virginia.

Reasonable Forseeability

The *reasonable forseeablility* rule results in the broadest scope of third-party liability for the accountant. In 1983, the New Jersey Supreme Court concluded that accountants have a duty to all those whom they should reasonably foresee as receiving and relying on the accountant's work product. At present, only Mississippi and Wisconsin apply the reasonable forseeability rule.

In addition to the thirty-seven states mentioned above, thirteen states (Delaware, Indiana, Kentucky, Maine, Maryland, Nevada, New Mexico, North Dakota, Oklahoma, Oregon, Rhode Island, South Dakota, and Vermont) do not have definitive legislation or case law.

To determine specific legal liability in the state in which you reside, you should seek the advice of local legal counsel.

Executive Summary—Current Practice Issues

- Applicability of SSARS 1 has changed due to the issuance of SSARS 8. The definition of *submission of financial statements* (the action that triggers SSARS 1) has changed.
- Although all SSARS do not apply to every compilation and review engagement, you should note the interaction of the standards.
- Independence is a complex area. Consequently, the AICPA developed a new user-friendly Audit Risk Alert which is a guide to understanding the subject of independence, *The ABCs of Independence* (Product No. 022271kk).

- The authoritative requirements for an engagement letter depend upon the kind of engagement you are going to perform. Some engagements now require a *written* engagement letter.
- Legal liability to third parties in compilation and review engagements depends upon the legal standard used in your state. You should consult with local legal counsel for advice on liability under your state law.

Engagement Issues

Inquiries and Analytical Procedures in SSARS Review Engagements

What are the required inquiries in a SSARS review engagement? Can I modify them? What are the requirements for analytical procedures? What are examples of analytical procedures? What is the purpose of inquiries and analytical procedures?

SSARS 1 states that the accountant should ordinarily include inquiries directed to the following:

- The entity's accounting principles and practices and the methods followed in applying them
- The entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements
- Actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements
- Persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with GAAP 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

Appendix A of SSARS 1 contains illustrative inquiries for a review engagement. Nevertheless, these illustrative inquires are not intended to serve as a program or checklist in the conduct of a review. Rather, they are guidelines and a frame of reference because the inquiries to be made in a review engagement are a matter of your judgment. Tailor specific inquiries to the client based on the your understanding of the client's business and the industry in which it operates.

SSARS 1 states that the accountant's analytical procedures should ordinarily consist of procedures designed to identify relationships and individual items that appear to be unusual. For a review engagement, these procedures fall into the following three categories:

- Comparison of the financial statements with statements for comparable prior period(s) (An example would be trend analysis, which involves the study of the change in accounts over time.)
- Comparison of the financial statements with anticipated results, if available, such as, budgets and forecasts (An example would be comparing budgeted amounts to actual amounts and identifying significant variances.)
- 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 (An example would be reasonableness tests that estimate a financial statement amount or the change in amount from the prior period.)

A basic premise underlying the application of analytical procedures is that relationships among data may reasonably be expected to exist and continue to exist in the absence of known conditions to the contrary. Again, the specific analytical procedures used are a matter of your judgment. Tailor the specific procedures to the client based on your understanding of the client's business and the industry in which it operates.

When the results of analytical procedures are unfavorable (meaning, when they identify significant fluctuations), SSARS 1 requires you to apply additional procedures. You may use the results of the analytical procedures as a basis for making additional inquiries. You must achieve limited assurance that no material modifications are necessary in order for the financial statements to be in conformity with GAAP.

Overall, the purpose of the inquiries and analytical procedures is to provide you with the primary basis for expressing limited assurance that no material modifications should be made to the financial statements. SSARS 1 does not specify how many procedures must be performed in order to express the limited assurance. The extent and kind of procedures performed is a matter of professional judgment.

The Management Representation Letter in a SSARS Review Engagement

What is the authoritative requirement for a management representation letter? Is it required for a review engagement? A compilation engagement?

SSARS 1 requires that, in a review engagement, you obtain a representation letter from members of management whom the accountant believes are responsible for and knowledgeable about the matters covered in the representation letter. A management representation letter is not required in a compilation engagement (However, the AICPA *Personal Financial Statement Audit Guide* (Product No. 011136kk) *recommends* that practitioners obtain a representation letter in all personal financial statement engagements, even in a compilation.).

Normally, the chief executive officer (CEO) and chief financial officer (CFO) would sign the management representation letter. Appendix D of SSARS 1 provides an illustrative management representation letter. Note that this illustrative letter was updated in February 1999.

You should tailor the management representation letter to the client based on your knowledge of the client's business and the industry in which it operates. You may add additional representations to the letter, especially if the client operates in a specialized industry (for example, construction contractors, homeowners' associations, or not-for-profit organizations). These additional representations may be found in AICPA Industry Audit and Accounting Guides.

Help Desk: See the "On the Bookshelf" section of this Alert for a list of available guides. You may obtain these guides by calling the AICPA Order Department at (888) 777-7077.

References and Legends on Financial Statements

What is the SSARS requirement for references and legends on the financial statements? Does that requirement differ in compilation and review engagements? Can you modify the references and legends from the examples in SSARS?

The kind of reference or legend on the financial statements depends upon the kind of engagement, as follows.

- If the financial statements are reviewed, each page of the financial statements should contain a reference, such as, "See 'The Accountant's Review Report.'"
- If the financial statements are compiled for general use (meaning, not restricted to management's use only), each page of the financial statements should contain a reference, such as, "See 'The Accountant's Compilation Report.'"
- If the financial statements are compiled for management's use only, each page of the financial statements should contain a reference to the restricted nature of the financial statements, such as either of the following:
  – Restricted for Management's Use Only
  – 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
- If the financial statements are compiled and included in certain prescribed forms (SSARS 3), each page of the form should include a reference, such as "See 'The Accountant's Compilation Report.'"
- If the financial statements are personal financial statements prepared for inclusion in a personal financial plan (SSARS 6), each of the personal financial statements should contain a reference to the report, such as, "See 'The Accountant's Report.'"

Note that, in all cases, these requirements extend to the footnotes (since the footnotes are part of the financial statements). Nevertheless, there is diversity in practice as to how to meet this requirement for footnotes. A number of practitioners place the reference on each page of the footnotes, and others place the reference only on the first page of the footnotes. Still others place a statement on each page of the financial statements that "the notes are an integral part of the financial statements" and, therefore, do not place the reference on the footnote pages. Any of these approaches is acceptable.

Also, the references above are examples given in SSARS, and you may modify the wording of the reference. SSARS, as amended, requires only that you refer to the report, not that you state the kind of report (level of service) in the reference. Therefore, the reference, "See 'The Accountant's Report,'" would be sufficient in all engagements that contain a report. However, most practitioners follow the wording given in the examples. Accountants may place the reference on the financial statements by installing footers in the financial statement software, by using a rubber stamp, by manually writing the reference, or by any other method that is practical.

Subsequent Discovery of Facts After the Date of the Report

What is my responsibility concerning subsequent discovery of facts existing at the date of my compilation or review report?

After compiling or reviewing a client's financial statements and issuing a report, you may become aware of facts that lead you to believe that information supplied by the entity may have been incorrect, incomplete, or otherwise unsatisfactory had you then been aware of such facts. In this case, you may wish to consider the guidance in SAS No. 1, *Subsequent Discovery of Facts Existing at the Date of the Auditor's Report* (AICPA, *Professional Standards*, vol. 2, AU sec. 561).

Consider the following two factors in determining the appropriate course of action.

- *The reliability of the information*. If you believe that the information is reliable and that it existed at the date of your report, and if the information indicates that the financial statements, your report, or both, need revision, you would ordinarily conclude that persons known to be relying on or likely to rely on the financial statements should be notified in an appropriate manner.

- *The existence of persons known to be relying on or likely to rely on the financial statements*. In evaluating the likelihood that users are currently relying on or likely to rely on the financial statements, you should consider the time elapsed since the financial statements were issued.

Because of the legal implications involved in these actions, you should consider consulting with an attorney before proceeding.

Executive Summary—Engagement Issues

- Inquiries and analytical procedures are an integral part of a review engagement. The inquiries and analytical procedures form the basis for your conclusion that no material modifications to the financial statements are necessary. Always tailor the inquiries and analytical procedures to your client and to the industry in which your client operates.
- A management representation letter is required in a review engagement (but not in a compilation engagement) and should be tailored to your client and to the industry in which your client operates.
- References or legends are required on each page of financial statements that you compile or review. The actual wording of the reference and legend will vary depending on the engagement.
- If, after compiling or reviewing a client's financial statements and issuing a report, you become aware of facts that lead you to believe that information supplied by the entity may have been incorrect, incomplete, or otherwise unsatisfactory had you then been aware of such facts, you may wish to consider the guidance in SAS No. 1.

Accounting and Reporting Issues

Reporting When a Client Has Comprehensive Income

What is the requirement for presenting comprehensive income? How is the wording of the compilation or review report modified for comprehensive income? Can I omit the presentation?

According to Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 130, *Reporting Com-*

prehensive Income, all business entities that have any component of comprehensive income must display information about comprehensive income in a financial statement having the same prominence as the other basic financial statements. The four components of other comprehensive income are the following:

- Unrealized gains and losses arising from investments in marketable securities classified as “available for sale” (FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*)
- Foreign currency translation adjustments, and gains and losses from certain foreign currency transactions (FASB Statement No. 52, *Foreign Currency Translation*)
- Minimum pension liability adjustments (FASB Statement No. 87, *Employers' Accounting for Pensions*)
- Unrealized gains and losses arising from certain derivative transactions (FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*)

If an entity does not have any of these components of comprehensive income, FASB Statement No. 130 does not apply. As a result, you will find that most of your small business clients do not have to apply FASB Statement No. 130.

FASB Statement No. 130 does not specify a format for presenting comprehensive income, although it provides examples that present the information in the following three kinds of statements:

- The income statement (after net income)
- The statement of changes in equity
- A separate statement of comprehensive income

You may have to modify the wording of the introductory paragraph of the compilation or review report depending on how you choose to report comprehensive income. If comprehensive income is reported in the income statement, then you will need to modify the title of the statement (“Statement of Income and Comprehensive Income”). If comprehensive income is reported in a separate statement, then you will need to reference an additional statement in the report. If comprehensive income is reported in the statement of changes in equity, then no modification to the report is necessary.

However, in compiled financial statements, the presentation of comprehensive income may be omitted by identifying the omission (in much the same way that a statement of cash flows is omitted). Depending on the kind of engagement, the omission will be identified in the report accompanying the financial statements or in the engagement letter (management-use only financial statements).

Reporting When Supplementary Information Is Included

What is supplementary information? What does SSARS require if supplementary information is presented?

The following 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 the standard compilation or review report if supplementary information is included?

The term *supplementary information* is not defined in SSARS. 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 kind of information as follows:

- 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

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

- 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 salesman

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." If you present a separate report on the supplementary information, it should follow the title page.

SSARS 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.

If the basic financial statements are compiled, then the compilation report should be modified, as shown in the following example [modification appears in italics].

> 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, *and the accompanying supplementary information contained in Schedules A and B, which are presented only for supplementary analysis purposes*, 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 and supplementary schedules* information that is the representation of management. We have not audited or reviewed the accompanying financial statements *and supplementary schedules* and, accordingly, do not express an opinion or any other form of assurance on them.

If the basic financial statements are reviewed, the degree of responsibility is indicated either in your review report on the basic financial statements or in a separate report on the other data. Specifically, the report should state that the review was 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 GAAP, and either of the following.

- 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 financial statements, and you did not become aware of any material modifications that should be made to such data (in other words, you are stating that you also *reviewed* the supplementary information).
- 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 financial statements, but were compiled from information that is the representation of management, without audit or review, and you do not express an opinion or any other form of assurance on such data (in other words, you are stating that you reviewed the financial statements but only *compiled* the supplementary information).

In any case, the important thing to remember is to clearly indicate the degree of responsibility you are taking for any information accompanying the basic financial statements.

How should a compilation or review report be modified for OCBOA financial statements?

In general, the only report modification necessary when preparing financial statements using OCBOA other than GAAP is the identification of the financial statements. Since financial statements prepared using an OCBOA must contain modified titles (for example, "Statement of Assets, Liabilities, and Equity—Income Tax Basis" instead of "Balance Sheet"), your compilation or review report should refer to the modified titles actually used on the statements (for example, "We have compiled the accompanying statement of assets, liabilities, and equity—income tax basis.…")

Nevertheless, when you compile OCBOA financial statements that omit substantially all disclosures, SSARS 1 requires that you disclose the basis of accounting. This disclosure may be in an attached footnote or in a note on the face of the financial statements. If disclosure is not made as part of the financial statements, you should modify your compilation report to include that disclosure. For example, you could add the following sentence to the first paragraph of the standard compilation report.

> The financial statements have been prepared on the accounting basis used by the Company for federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In addition, if substantially all disclosures have been omitted, you must communicate this fact in the compilation report, by adding the following paragraph.

> Management has elected to omit substantially all disclosures ordinarily included in financial statements prepared on the income tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's assets, liabilities, equity, revenue, and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

Help Desk: For more information on this topic, see the AICPA practice aid, "Preparing and Reporting on Cash- and Tax- Basis Financial Statements (Product No. 006701kk), which interprets the auditing literature to clarify the guidance on cash-and tax-basis financial statements.

Reporting on Personal Financial Statements

How should a compilation or review report be modified for personal financial statements?

In general, the only report modifications necessary when presenting personal financial statements are the identification of the financial statements and identification of the reporting entity. The following is an example.

> I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of December 31, 20XX, and the related statement of changes in net worth 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 the individuals whose financial statements are presented. 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.

Nevertheless, if you compile personal financial statements that omit substantially all disclosures, the AICPA *Personal Financial Statements Guide* (Product No. 011136kk) requires that you disclose that assets are presented at their estimated current values and liabilities are presented at their estimated current amount. This disclosure may be made in an attached footnote or in a note on the face of the financial statements. If disclosure is not made as part of the financial statements, modification of your compilation report would be required. For example, the following sentence could be added to the first paragraph of the standard compilation report.

> The financial statement(s) is (are) intended to present the assets of James and Jane Person at estimated current values and their liabilities at estimated current amounts.

In addition, if substantially all disclosures have been omitted, you must communicate this fact in the compilation report, by adding the following paragraph.

> The individuals whose financial statements are presented have elected to omit substantially all 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 individuals' assets, liabilities, and net worth. Accordingly, these financial statements are not designed for those who are not informed about such matters.

Disclosures in Compiled Financial Statements

Do compiled financial statements have to include footnote disclosures? What if some disclosures are included, but not all?

In general, all financial statements should include adequate disclosures (footnotes). However, there are situations in which you may omit one or more disclosures. Depending upon the situation, the compilation report may have to be modified.

If all disclosures are omitted, you should add an extra paragraph to the compilation report, as follows.

> Management has elected to omit substantially all of the disclosures (and the statement of comprehensive income and the 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.

Note that, if the financial statements are presented on a basis of accounting other than GAAP (for example, income tax basis), this extra paragraph would be reworded to refer to the specific basis of accounting used in preparing the financial statements. An example of a paragraph that might be used when the financial statements have been prepared in conformity with the income tax basis of accounting follows.

> Management has elected to omit substantially all of the disclosures ordinarily included in financial statements prepared on the income tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's assets, liabilities, equity, revenues, and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

This additional paragraph is appropriate if all or substantially all disclosures are omitted. The additional paragraph is not appropriate if substantially all disclosures are included (most, but not all disclosures). If selected disclosures are included, they should not be labeled as "Notes to the Financial Statements" (this title implies full disclosure). Instead, an appropriate title would be "Selected Information—Substantially All Disclosures Required by GAAP Are Not Included."

Executive Summary—Accounting and Reporting Issues

- FASB Statement No. 130 requires presentation of comprehensive income if an entity has one or more components of "other comprehensive income." You may omit this presentation in compiled financial statements as long as you note this omission in the compilation report.
- Supplementary information includes any information (schedules, charts, graphs, tables, and so on) that is not identified as being part of the basic financial statements. SSARS 1, as amended, requires that you indicate in your compilation or review report the degree of responsibility you are taking for such information.
- Reporting on OCBOA financial statements may result in several modifications to the standard compilation or review report.
- Reporting on personal financial statements may result in several modifications to the standard compilation or review report.
- If management elects to omit substantially all disclosures from compiled financial statements, you must modify your compilation report to identify this omission.

Peer Review Issues

Peer Review Requirements—Old and New

What are the revisions to the peer review standards, and how do they affect compilation and review engagements?

At its October 5, 1999, meeting, the AICPA Peer Review Board (PRB) adopted revisions to the AICPA Standards for Performing and Reporting on Peer Reviews and Interpretations that will become effective for peer reviews *commencing* on or after January 1, 2001. (Earlier implementation is not allowed.)

There will be three kinds of peer reviews, as described in the following.

- *System Review*. This kind of review is for firms that perform engagements under the SASs, Government Auditing Standards (also referred to as the Yellow Book), and examinations of prospective financial information under the Statements on Standards for Attestation Engagements. The system review is essentially the same as the former on-site peer review with only a name change.
- *Engagement Review*. This kind of review is for firms that are not required to have a system review (and who are not eligible to have a report review discussed below). The engagement review is similar to the former off-site peer review (with a separate report and letter of comments, technical review, committee acceptance, monitoring actions, and so on). In an engagement review, the two objectives are to provide the peer reviewer with a reasonable basis for expressing limited assurance of the following.
  - The financial statements or information and the related accountant's report on the accounting, review, and attestation engagements submitted for review conform in all material respects with professional standards (same as in the former off-site review).
  - The reviewed firm's documentation on the engagements submitted for review conform with the requirements of

the SSARS and the SSAEs, as applicable, in all material respects with professional standards (new under the revised standards). Examples of documentation, in a review engagement, would include the management representation letter, and the documentation of the matters covered in the accountant's inquiry and analytical procedures. On an engagement review, there is no opinion on the reviewed firm's system of quality control and, therefore, the reviewer is not opining on the firm's compliance with its own quality control policies and procedures or with quality control standards.

- *Report Review*. Firms that only perform compilations that omit substantially all disclosures would have a report review. However, a firm must have an engagement review if it performs, as its highest level of service, compilations referred to in SSARS as "selected information – substantially all disclosures required are not included."

The objective of a report review is to enable the reviewed firm to improve the overall quality of its compilation engagements that omit substantially all disclosures. To accomplish this objective, the reviewer provides a report with a list of comments and recommendations, if any, based on whether the financial statements and the related accountant's reports appear to conform with the requirements of professional standards in all material respects. The kinds of comments and recommendations are not only those that would result in a modified report on an engagement review, but also those intended to improve the overall quality of the reviewed firm's practice. Nevertheless, the comments should be relevant and supportable by professional standards, and reasonably detailed so that the reviewed firm can evaluate what appropriate actions should be taken.

For report reviews, the peer review reports are not identified as unmodified, modified, or adverse as might be the case with system and engagement reviews. The report is required to be signed by an authorized member of the reviewed firm acknowledging that there are no disagreements on significant matters, and that the firm agrees to correct any matters that are commented upon within the report. The firm then must submit the copy of the report it has signed to the entity administering the peer review. For report reviews, there is no separate letter of comments and letter of response as in the case with system and engagement reviews. Nevertheless, a firm is not prohibited from attaching a response to the copy of the report it has signed. The administering entity must technically review all peer reviews. However, on report reviews only, the technical reviewer generally should have the authority to accept report reviews on behalf of the administering entity's peer review committee (PRC) when he or she determines that there are no significant issues. This should streamline the process for many firms. Only the PRC may impose corrective actions on the firm and/or reviewer.

If a firm's most recent review was a report review, then the firm's members are not eligible to perform peer reviews. A firm's members are eligible to be engagement and report reviewers if they meet all of the other reviewer requirements and, on its last peer review, the firm had an unqualified, unmodified report on his or her firm's system of quality control, engagement review, or off-site peer review until phased out. Nevertheless, the peer reviewer should also be currently reviewing or performing the same kind of engagements.

If a firm's most recent review was a report review, then the firm's members are not eligible to be charged with the responsibility for acceptance of any reviews. Committee members charged with the responsibility for the acceptance of reviews must have at least received an unqualified/unmodified report on his or her firm's system of quality control, engagement review, or off-site peer review until phased out.

For further information on the impact of these changes on your compilation or review practice, you should contact your peer review administering entity in your state.

In addition to the revisions to peer review standards, certain other developments have affected the peer review process with respect to compilation engagements. They are as follows.

- *AICPA Bylaw Change*. Individual members *must themselves enroll* in an Institute-Approved Practice-Monitoring Program (Program) if they perform and issue reports on compilation engagements in firms or organizations that *are not eligible* to enroll in such a program. Accordingly, these enrolled individuals are reviewed in a manner similar to that of a sole practitioner. On the other hand, individual members who are practicing with a firm that *is eligible* to enroll in an Institute-Approved Practice-Monitoring Program *may not enroll* in such a program as an individual. In those cases, the firm must still enroll.

- *SSARS No. 8.* If a compilation is issued with an engagement letter and without a report, and it is the only accounting and auditing service performed by the firm, the firm would not be required to enroll in an Institute-Approved Practice-Monitoring Program because no reports were issued. If a firm is already enrolled in such a Program, and performs these compilation engagements, most likely, in conjunction with other kinds of accounting and auditing engagements, this kind of engagement would be included in the definition of the firm's accounting and auditing practice, and would be within the scope of peer review. In addition, if a firm is already enrolled, even though it is not required, and chooses not to resign from the AICPA Peer Review Program, that firm is subject to peer review if it performs these engagements as its only accounting and auditing engagements.

Recurring Deficiencies Noted in Compilation and Review Engagements

What are some of the most frequent deficiencies identified in peer reviews that relate to compilation and review engagements?

Of the more than 30,000 firms in the AICPA Peer Review Program, almost 18,000 perform reviews or compilations as their highest level of service. Forty-one entities administer the AICPA Peer Review Program for the fifty-four state CPA societies (including the District of Columbia, Guam, Puerto Rico, and the Virgin Islands).[2] The importance of the peer review findings cannot be

2. AICPA, *Journal of Accountancy* (August 2000, pp. 57-60).

overemphasized. Here, we provide you with a number of recent significant and minor deficiencies that you can keep in mind when planning and staffing your compilation and review engagements.

Significant Deficiencies

Significant deficiencies include matters that normally (1) are material to understanding the financial statements or accountant's report or (2) represent a critical SSARS procedure. An engagement with a significant deficiency is normally considered substandard. Frequently mentioned significant deficiencies in compilation and review engagements that have been noted in peer review comment letters include the following.

Reports

The following are significant deficiencies that can occur in reports:

- Omissions of required reporting elements of applicable standards
- Issuance of a review report when the accountant is not independent
- Failure to disclose lack of independence in a compilation report
- Failure to disclose the omission of substantially all disclosures
- Failure to disclose the omission of the statement of cash flows in financial statements prepared in accordance with GAAP
- Failure to disclose an OCBOA for financial statements compiled without disclosure, if the basis of accounting is not readily determinable from reading the report
- Failure to disclose, in the accountant's report, a material departure from professional standards (Examples include the omission of significant income tax provision in interim financial statements; omission of significant disclosures related to material defined employee benefit plans; or nonrecognition of significant deferred income.)

Financial Statement Measurement, Presentation, and Disclosure

The following are significant deficiencies that can occur in financial statement measurement, presentation, and disclosure:

- Inclusion of material balances that are not appropriate for the basis of accounting used
- Failure to include a material amount or balance necessary for the basis of accounting used (Examples include the omission of material accruals, failure to amortize a significant intangible asset, failure to provide for material losses or doubtful accounts, or failure to provide for material deferred income taxes.)
- Significant departures from the financial statement formats prescribed by industry audit and accounting guides
- Omission of significant required disclosures related to material financial statement balances or transactions
- Omission of disclosure of significant accounting policies applied (GAAP or OCBOA)
- Omission of significant matters related to the understanding of the financial statements (the cumulative material effect of a number of disclosure deficiencies)
- Improper accounting of a material transaction (for example, recording a capital lease as an operating lease)
- Misclassification of a material transaction or balance
- Failure to include a summary of significant assumptions in a financial forecast or projection
- Use of a statement of changes in financial position in which a statement of cash flows is appropriate
- Failure to segregate the statement of cash flows into the components of operating, investing, and financing activities
- Failure to include a statement of cash flows for every period for which an income statement was presented.

SSARS Procedures and Documentation

The following are significant deficiencies that can occur in SSARS procedures and documentation:

- Failure to perform inquiries and analytical procedures in review engagements
- Failure to document matters covered in the accountant's inquiry and analytical procedures in review engagements
- Failure to "read" compiled financial statements for obvious or material errors
- Failure to obtain client management representation letters in review engagements

Minor Deficiencies

Minor deficiencies include departures from professional standards that (1) are not normally material to a proper understanding of the financial statements or accompanying accountant's report or (2) do not represent a critical SSARS procedure. As a result, these departures, by themselves, would not usually cause an engagement to be substandard. Frequently mentioned minor deficiencies in compilation and review engagements that have been noted in peer review comment letters are described in the following sections.

Reports

The following are minor deficiencies that can occur in reports.

- Failure to report on supplementary information
- Minor departures from standard report language, provided the report is not otherwise misleading about the degree of responsibility taken
- Failure to reference all time periods encompassed by the financial statements
- Inconsistencies between titles presented in the accountant's report and those actually appearing on the financial statements (basis of accounting determinable)

- Inclusion of a reference about the omission of the statement of cash flows for financial statements prepared on an OCBOA (A statement of cash flows is not required for financial statements prepared on an OCBOA.)
- Minor report-dating departures
- Failure to disclose an OCBOA for financial statements compiled without disclosure if the basis of accounting is otherwise readily determinable from reading the report
- Omission of a reference to a statement of changes in equity (included with the financial statements)
- Failure to make references to the AICPA as required by SSARS 7

Financial Statement Measurement, Presentation, and Disclosure

The following are minor deficiencies that can occur in financial statement measurement, presentation, and disclosure:

- Omitted or inadequate disclosures related to minor account balances or transactions (for example, minor disclosure deficiencies related to accounting policies, inventory, valuation allowances, long-term debt, related-party transactions, concentrations of credit risk, deferred income taxes, and employee benefit plans)
- Minor departures from the financial statement formats recommended by industry audit and accounting guides
- Failure to reference the financial statements to the accountant's report or the accompanying footnotes
- Use of financial statement titles that are not appropriate for the basis of accounting used when the accountant's report, financial statements, or footnotes otherwise indicate the basis of accounting
- Failure to include the title, "Selected Information—Substantially All Disclosures Required by Generally Accepted

Accounting Principles (or Another Basis of Accounting) Are Omitted," as appropriate for the presentation of certain selected disclosures

- Failure to accrue income taxes where the accrual and provision are expected to be immaterial to the financial statements taken as a whole

SSARS Procedures and Documentation

The following minor deficiencies can occur in SSARS procedures and documentation:

- Minor documentation deficiencies related to review engagements (dating of representation letter)

Although there are many recurring deficiencies noted in peer review, you can take steps to avoid them by keeping these common mistakes in mind as you plan and perform future compilation and review engagements. Peer review is an educational process, and you can learn from past mistakes.

Executive Summary—Peer Review Issues

- Beginning January 1, 2001, there will be three kinds of peer review: system review, engagement review, and report review (replacing the two previous kinds, which were on-site and off-site).
- The kind of review that you will be subject to will depend upon the kinds of engagements that you perform.
- You should check with your peer review administering entity for information on how these changes will affect your firm.
- In addition to revisions to peer review standards, two other developments have affected the peer review process regarding compilation engagements—the AICPA bylaw change and the issuance of SSARS 8.
- Several kinds of deficiencies in compilation and review engagements are found on a recurring basis.
- You should be aware of the common kinds of engagement deficiencies and take steps to avoid the common mistakes.

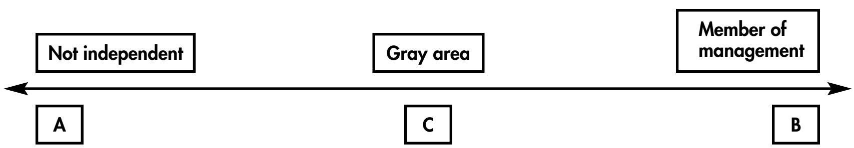
Ongoing Issues and Future Developments

Controllership and Controller by-the-Hour Services

What is the current status of the ARSC's deliberations on controllership and controller-by-the-hour services?

ARSC has just started deliberations on the controllership issue. See exhibit 2, "Controllership Services," which illustrates this issue.

Exhibit 2—Controllership Services



Assume CPA *A*, depicted in Exhibit 2, is in public practice and performs various services (tax returns, payroll, write-ups, consulting, compilations, and so on) for a number of different clients. Further, assume that CPA *A* is not independent with respect to a particular client.

Question: Can CPA *A*, as depicted in Exhibit 2, compile financial statements for those clients of which he or she is not independent?

Answer: Yes. As long as the lack of independence is disclosed in the compilation report.

Assume CPA *B* is an employee of ABC Construction Company (a CPA in industry). This CPA is the CFO of the company and is not in public practice. In this position, CPA *B* performs a number of typical management functions in his or her position as CFO, including the preparation of monthly financial statements for use by management. Further, assume that CPA *B* sends a copy of the internally prepared financial statements to the bank each month.

Question: Should CPA *B* compile and attach a compilation report to those financial statements that he or she prepares?

Answer: No. CPA *B* is a member of management, and the financial statements are his or her representations. Therefore, it would not be appropriate to attach a compilation report to those financial statements.

Assume CPA *C* is a CPA in public practice and performs various services (tax returns, payroll, write-up, consulting, compilations, and so on) for a number of different clients. Further, assume that CPA *C* has one or more clients for which he or she serves as a fee-basis controller (not an employee). He or she performs a number of typical management functions in his or her position as *controller*, including preparation of monthly financial statements for use by management.

Question: Should CPA *C* compile and attach a compilation report to those financial statements that he or she prepares for those clients?

Answer: There is no clear answer. On one hand, CPA *C* is in public practice, and the argument can be made that the financial statements should be compiled with a report attached (because the CPA is submitting financial statements). On the other hand, CPA *C* is, in substance, part of management. Consequently, the argument can be made that the financial statements are his or her own representations and, therefore, compiling the financial statements with a report is not appropriate. Keep in mind, however, that most accountants believe that CPA *C* would be at greater risk if the decision is that he or she is part of management (and does not attach a compilation report). The potential risk stems from the fact that a compilation report communicates to the reader the accountant's responsibility (no assurance is provided) and the limitations in the financial statements. If the financial statements are not expected to be used by third parties, then a management-use only compilation may be appropriate. In other situations, CPA *C* may be able to minimize risk with an appropriately worded engagement letter.

ARSC has not reached any conclusion on this issue. They are considering various alternatives and kinds of guidance. In the meantime, use your professional judgment as a guide to your interpretation of this issue.

Financial Statements Included in Written Business Valuations

What is the current status of the ARSC's deliberations on financial statements included in business valuations? What is the status of the exposure draft that would have created an exemption from SSARS 1 for financial statements included in written business valuations?

In December 1999, the ARSC issued an exposure draft entitled *Financial Statements Included in Written Business Valuations.* The exposure draft would have exempted historical financial statements from SSARS 1 if the financial statements were only for use in a business valuation and were not to be used to obtain credit or for any other purpose. In other words, the accountant would not be required to compile or report on financial statements included in a written business valuation as long as those conditions were met. At its August 2000 meeting, the ARSC voted to defer action on this proposal until more study could be done on the larger issue of exemptions. Currently, the following are the three specific exemptions from SSARS 1 for historical financial statements:

- Personal financial statements included in written personal financial plans (See SSARS 6.)
- Financial statements included in certain prescribed forms (See SSARS 3.)
- Financial statements submitted in conjunction with certain litigation support services (See Interpretation No. 20, "Applicability of Statements on Standards for Accounting and Review Services to Litigation Services," of SSARS 1.)

The ARSC is attempting to develop a conceptual framework for exemptions under which any future deliberations should take place. Until that happens, the proposed exemption for financial statements included in business valuations has been tabled.

Executive Summary—Ongoing Issues and Future Developments

- Although SSARS contains guidance for situations when you are not independent, there is no specific guidance for situations if you go beyond simply being not independent and actually perform substantial management functions for a client.

- A number of practitioners believe that if a CPA performs management functions for a client, SSARS does not apply.
- Until the ARSC issues guidance in this area, you should use your professional judgment to determine the appropriate course of action.
- In December 1999, the ARSC issued an exposure draft entitled *Financial Statements Included in Written Business Valuations* that would have exempted historical financial statements from SSARS 1 if the financial statements were only for use in a business valuation and were not to be used to obtain credit or for any other purpose.
- The ARSC has delayed action on this exposure draft while they examine the broader issue of exemptions from SSARS 1.

Recent GAAP Pronouncements

What recently issued GAAP pronouncements are important for your consideration?

In addition to the pronouncements and other issues described previously in this Alert that directly affect reviews and compilations, we include other recent pronouncements here for your consideration. Included are pronouncements from the FASB and the Accounting Standards Executive Committee (AcSEC). For updates on additional pronouncements see the AICPA General *Audit Risk Alert—2000/01* (Product No. 022260kk).

FASB Pronouncements

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*	This Statement replaces FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and revises the standards for accounting for securitizations and other transfers of financial assets and collateral and requires certain disclosures, but carries over most of the provisions of FASB Statement No. 125. FASB Statement No. 140 is effective for transfers and the servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001; and for the recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending

(*continued*)

	after December 15, 2000. There is no reporting requirement for disclosures about securitization and collateral accepted for periods ending on or before December 15, 2000, for which financial statements are presented for comparative purposes.
FASB Statement No. 139, *Rescission of FASB Statement No. 53 and amendments to FASB Statements No. 63, 89, and 121*	FASB Statement No. 139 rescinds FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*. An entity that previously was subject to the requirements of FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*, shall follow the guidance in AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films*. This Statement also amends FASB Statements No. 63, *Financial Reporting by Broadcasters*; 89, *Financial Reporting and Changing Prices*; and 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.* FASB Statement No. 139 is effective for financial statements for fiscal years beginning after December 15, 2000. Earlier application is permitted only upon early adoption of the Statement of Position.
FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*	This Statement addresses a limited number of issues causing implementation difficulties for numerous entities that apply FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. This Statement amends the accounting and reporting standards of FASB Statement No. 133 for certain derivative instruments and certain hedging activities. This Statement is effective for an entity that has not adopted FASB Statement No. 133 before June 15, 2000, concurrently with FASB Statement No. 133 according to the provisions of paragraph 48 of FASB Statement No. 133. For an entity that has adopted FASB Statement No. 133 prior to June 15, 2000, this Statement is effective for all fiscal quarters beginning after June 15, 2000, in accordance with certain transition provisions.

FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*	Among other issues, Interpretation No. 44 clarifies (*a*) the definition of employee for purposes of applying Opinion 25, (*b*) the criteria for determining whether a plan qualifies as a noncompensatory plan, (*c*) the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and (*d*) the accounting for an exchange of stock compensation awards in a business combination.
AcSEC Statements of Position	
SOP 00-2, *Accounting by Producers or Distributors of Films*	This SOP provides guidance on generally accepted accounting principles for all kinds of films, except where specifically noted, and is applicable to all producers or distributors that own or hold rights to distribute or exploit films. The SOP is effective for financial statements for fiscal years beginning after December 15, 2000, with earlier application encouraged.

Resource Central

On the Bookshelf

What other AICPA publications may be of value to my practice?

AICPA Audit and Accounting Guides

Although the audit guidance contained in many of the Audit and Accounting Guides may not affect practitioners performing compilation and review engagements significantly, the industry background, accounting guidance, and illustrative financial statements provided should help you acquire knowledge of a specific industry. The following Audit and Accounting Guides summarize the practices applicable to specific industries and describe relevant matters, conditions, and procedures unique to these industries. The accounting guidance included in AICPA Audit and Accounting Guides is in the GAAP hierarchy as authoritative GAAP. These Guides are updated for authoritative pronouncements through May 1, 2000 (unless otherwise indicated), and are available from the AICPA (product numbers are shown in parentheses).

- *Agricultural Producers and Cooperatives 2000*—(012355kk)
- *Airlines 2000*—(013184kk)
- *Banks and Savings Institutions 2000*—(011179kk)
- *Brokers and Dealers in Securities 2000*—(012182kk)
- *Casinos 2000*—(013151kk)
- *Common Interest Realty Associations 2000*—(012489kk)
- *Construction Contractors 2000*—(012097kk)
- *Credit Unions 2000*—(012061kk)
- *Employee Benefit Plans 2000*—(012340kk)
- *Entities With Oil and Gas Producing Activities 2000*—(012107kk)
- *Federal Government Contractors 2000*—(012439kk)
- *Finance Companies 2000*—(012467kk)
- *Health Care Organizations 2000*—(012441kk)
- NEW AUDIT AND ACCOUNTING GUIDE! *Investment Companies 2000*—(012364kk)
- NEW AUDIT AND ACCOUNTING GUIDE! *Life and Health Insurance Companies 2000*—(012500kk)
- *Not-for-Profit Organizations 2000*—(013393kk)
- *Property and Liability Insurance Companies 2000*—(011923kk)
- *State and Local Governmental Units 2000*—(012061kk)

The following general Audit Guides also may be of interest to CPAs performing audit and attest engagements:

- *Consideration of Internal Control in a Financial Statement Audit 1997*—(012451kk)
- *Personal Financial Statements 2000*—(011136kk)
- *Prospective Financial Information 1999*—(011179kk)

- *Use of Real Estate Appraisal Information 1997*—(013159kk)
- NEW AUDIT GUIDE! *Auditing Derivative Instruments, Hedging Activities and Investments in Securities*—Practical Guidance for Applying SAS No. 92—(012520kk)

New Compilation and Review Alert With Implementation Guidance for the Recent Changes in SSARS

During the two years of discussions, debates, and comment letters, the ARSC continually stressed the need for educating practitioners about the changes that were being proposed. Consequently, in 2000, the AICPA developed a new Compilation and Review Alert, *Practical Guidance for Implementing SSARS 8* (Product No. 022274kk), that contains detailed explanations and examples of the changes that become effective January 1, 2001.

AICPA—At Your Service

How do I obtain AICPA publications and services related to my compilation and review practice? What other AICPA services may be of interest to me?

Order Department (Member Satisfaction)

To order AICPA products, call (888) 777-7077; write AICPA Order Department, CLA10, P.O. Box 2209, Jersey City, NJ 07303-2209; fax (800) 362-5066. For best results, call Monday through Friday between 8:30 a.m. and 7:30 p.m. EST. Obtaining product information and placing online orders can be done at the AICPA's Web site, http://www.aicpa.org.

Accounting and Auditing Technical Hotline

The AICPA Technical Hotline answers members' inquiries about accounting, auditing, attestation, compilation, and review services. Call (888) 777-7077.

Ethics Hotline

Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA *Code of Professional Conduct*. Call (888) 777-7077.

Internet Web Site

What's a good way to stay current on developments in the compilation and review arena? The AICPA has a Web site (www.aicpa.org). This site offers CPAs the unique opportunity to stay abreast of developments in compilation and review. The Web site is updated daily and includes the newsletter of the AICPA Audit and Attest Standards Team, *In Our Opinion*, which includes information on technical activities and developments in compilation and review matters. The Web site also offers highlights of ARSC meetings.

New! Online CPE Offer!

The AICPA has launched a new online learning tool, AICPA InfoBytes. An annual fee ($95 for members and $295 for nonmembers) will offer unlimited access to over one thousand hours of online CPE in one- and two-hour segments. Register today as our guest at http://infobytes.aicpaservices.org.

CD-ROMs Available

The AICPA is currently offering a new CD-ROM product, entitled reSource: *AICPA's Accounting and Auditing Literature*. This CD-ROM enables subscription access to the following AICPA Professional Literature products in a Windows format: *Professional Standards*, *Technical Practice Aids*, and *Audit and Accounting Guides* (available for purchase as a set that includes all Guides and the related Audit Risk Alerts, or as individual publications). This dynamic product allows you to purchase the specific titles you need and includes hypertext links to references within and between all products. To order any publications included on the CD-ROM, call (888) 777-7077.

CPE CD-ROM *The Practitioner's Update* (Product No. 738110kk). Keep on top of the latest standards with this interactive, computer-based auditing, and accounting update course. Issued twice a year, this cutting-edge course focuses primarily on new pronouncements that will become effective during the upcoming audit cycle.

Practitioners Publishing Company (PPC) and the AICPA are currently offering publications issued by PPC, the AICPA, and the

FASB on one CD-ROM disk, entitled *The Practitioner's Library—Accounting and Auditing*. The FASB publications include *Original Pronouncements*, *Current Text*, *EITF Abstracts*, and *FASB Implementation Guides*; and the AICPA publications include *Professional Standards*, *Technical Practice Aids*, *Audit and Accounting Guides*, and *Peer Review Program Manual*. The disk also contains eighteen PPC engagement manuals. The disk may be customized so that purchasers pay for and receive only selected segments of the material. For more information about this product call (800) 323-8724.

Test Your Knowledge

For each multiple choice or true/false question below, select the best answer. Correct answers are included at the end of the test.

After you have read and studied this Alert, find out how well you have mastered the material by completing the test below. The answers to the questions are also included.

_____ 1. The new definition of submission of financial statements includes which of the following?

a. Materially modifying client-prepared financial statements

b. Generating financial statements on a computer

c. Preparing financial statements either manually or through the use of computer software

d. Printing financial statements

_____ 2. Compiled financial statements do not need to have a report if they are restricted to employee use only.

TRUE FALSE

_____ 3. The new kind of compilation engagement is for financial statements restricted for which of the following?

a. Management's use only

b. Employee use only

c. Internal use only

d. Bank use only

_____ 4. Making material modifications to a client's computerized accounting database will "trigger" SSARS 1.

TRUE FALSE

_____ 5. All SSARS apply to every compilation and review engagement and must be followed for every engagement.

TRUE FALSE

_____ 6. SSARS 4 recommends that the successor accountant communicate with the predecessor accountant on every compilation and review engagement.

TRUE FALSE

_____ 7. A written engagement letter is required for all compilation and review engagements.

TRUE FALSE

_____ 8. The engagement letter for a compilation of financial statements for management's use only, must include all of the following, *except*

a. A description of the nature and limitations of the services to be provided

b. An acknowledgment of management's representation and agreement that the financial statements will not be used by third parties

c. A statement that the engagement cannot be relied upon to disclose fraud, errors, or illegal acts

d. A statement that the client will indemnify the accountant from any liability and related legal cost arising from third-party use of the financial statements

_____ 9. An accountant can be sued by a third party in a compilation engagement.

TRUE FALSE

_____ 10. Inquiries and analytical procedures are required in which of the following:

a. All SSARS engagements

b. Review engagements only

c. Review engagements and management-use only compilation engagements

d. Management-use only compilation engagements only

_____ 11. A management representation letter is required for all engagements to compile financial statements for management's use only.

TRUE FALSE

_____ 12. All financial statements compiled or reviewed under SSARS must contain a reference or legend.

TRUE FALSE

_____ 13. Comprehensive income information may be omitted from compiled GAAP financial statements.

TRUE FALSE

_____ 14. All of the following could be considered supplementary information, *except*

a. Cost of goods sold schedule

b. Budgets for an expired period

c. Income statement

d. Details of marketable securities

_____ 15. Disclosures may be omitted from all of the following, *except*

a. Compiled financial statements

b. Reviewed financial statements

c. Compiled financial statements for management's use only

d. Compiled personal financial statements

_____ 16. A firm that only performs compilation engagements (some with selected disclosures), would have which of the following kinds of peer review?

a. System review

b. Engagement review

c. Selected disclosure review

d. Report review

_____ 17. Which of the following engagements is permitted by existing compilation and review standards?

a. A restricted use compilation engagement (with a report)

b. An assembly service that is restricted to internal use

c. Plain paper financial statements (no restriction, no report)

d. None of the above

_____ 18. In compiled tax-basis financial statements, which of the following disclosures is required?

a. Identification of the basis of accounting

b. Reconciliation of the basis used to GAAP

c. Quantification of the differences from GAAP

d. All of the above

e. None of the above

_____ 19. An accountant is required to perform a review engagement only when engaged to do so.

TRUE FALSE

_____ 20. If personal financial statements omit substantially all disclosures, which of the following disclosures is (are) required?

a. Reconciliation of the estimated current value of assets to their cost

b. Quantification of the differences between estimated current values of assets and estimated current amounts of liabilities and their original cost or amount

c. A statement that the assets are presented at their estimated current values and the liabilities are presented at their estimated current amounts

d. All of the above

e. None of the above

Test Your Knowledge—Answers

1. *c*—The new definition of *submission of financial statements* does not include the terms generating, modifying, or printing.
2. FALSE—The only compiled financial statements that will not include a report are those restricted to <u>management's</u> use only.
3. *a*—The changes to SSARS 1 are very specific in that the financial statements are to be restricted to management's use only—not for employee or internal use.
4. FALSE—The new definition of *submission of financial statements* does not include *materially modifying*.
5. FALSE
6. TRUE
7. FALSE—An *understanding with the client is* required for all compilation and review engagements; a written engagement letter is required only when the financial statements are restricted for management's use only.

8. *d*—An indemnity clause is not required.
9. TRUE—The extent of your liability depends upon the principle used in your state.
10. *b*—Inquiries and analytical procedures are required only in review engagements—not in compilation engagements.
11. FALSE—Management representation letters are required only in review engagements. (although they are recommended in all personal financial statement engagements—even compilations)
12. TRUE—The type of reference or legend depends on the kind of engagement.
13. TRUE—The omission is identified in the compilation report in the same way as an omission of the statement of cash flows.
14. *c*—An income statement is, by definition, a financial statement and could not be considered supplementary information.
15. b—Substantially all disclosures may be omitted from any compiled financial statements by adding appropriate language to the compilation report or to the engagement letter (for financial statements compiled for management's use only).
16. *b*
17. *a*—Assembly service and plain paper financial statements are not permitted under existing standards.
18. *a*
19. TRUE
20. *c*

....

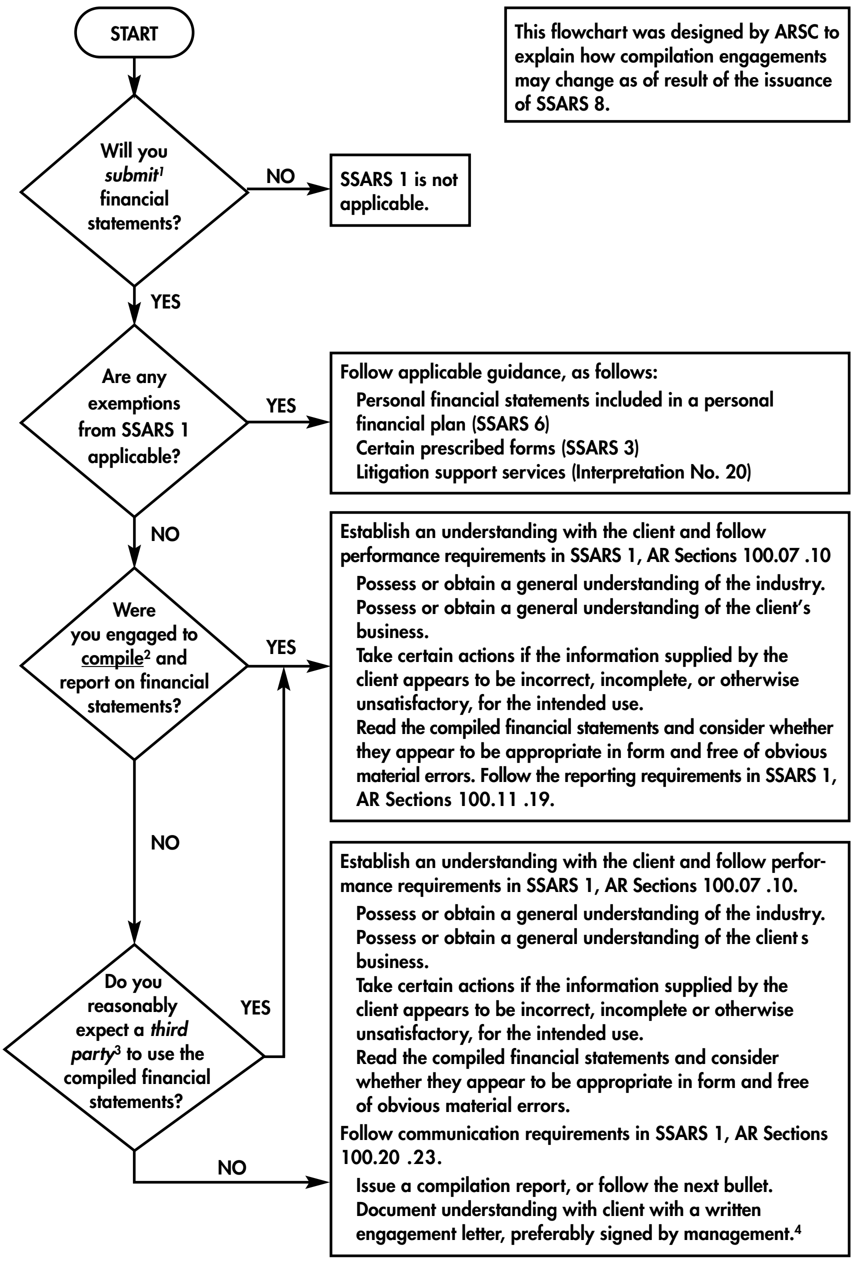
This Compilation and Review Alert replaces *Compilation and Review Alert—1999/2000.*

The Audit Risk Alert is published annually. As you encounter audit issues that you believe warrant discussion in next year's Audit Risk Alert, please feel free to share those with us. Any other comments that you have about the Audit Risk Alert would also be greatly appreciated. You may e-mail these comments to lgivarz@aicpa.org or write to:

Leslye Givarz
AICPA
Harborside Financial Center
201 Plaza Three
Jersey City, NJ 07311-3881

APPENDIX A

Compilation of Financial Statements



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 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 are not to 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 GAAP or 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 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 B

Compilation of Financial Statements Not Intended for Third-Party Use—Illustrative Engagement Letter

This illustrative engagement letter was designed by ARSC to be used in compilation engagements when the financial statements are not expected to be used by third parties.

[*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 bases 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*]

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 are [*fill in amount*].

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.*

Sincerely yours,

[*Signature of accountant*]

Accepted and agreed to:

XYZ Company

[*Title*]

[*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
The Internet—An Accountant's Research Tool

Here is a list of some useful Web sites that may provide valuable information to accountants doing compilations and reviews.

General Web Sites of Interest

Name of Site	*Content*	*Internet Address*
American Institute of CPAs	Summaries of recent auditing and other professional standards as well as other AICPA activities	http://www.aicpa.org
Financial Accounting Standards Board	Summaries of recent accounting pronouncements and other FASB activities	http://www.fasb.org
The Electronic Accountant	World Wide Web magazine that features up-to-the-minute news for accountants	http://www.electronic accountant.com
AuditNet	Electronic communications among audit professionals	http://www.cowan.edu. au/mra/home.htm
CPAnet	Links to other Web sites of interest to CPAs	http://www.cpalinks.com/
Accountant's Home Page	Resources for accountants and financial and business professionals	http://www.computer cpa.com/
Double Entries	A weekly newsletter on accounting and auditing around the world	http://www.csu.edu.au/lists. anet/ADBLE-L/index.html
U.S. Tax Code Online	A complete text of the U.S. Tax Code	http://www.fourmilab.ch/ ustax/ustax.html
Federal Reserve Bank of New York	Key interest rates	http://www.ny.frb.org/ pihome/statistics/dlyrates
Cybersolve	Online financial calculators, such as ratio and breakeven analysis	http://www.cybersolve.com/ tools1.html
FedWorld. Gov	U.S. Department of Commerce-sponsored site providing access to government publications	http://www.fedworld.com
Hoovers Online	Online information on various companies and industries	http://www.hoovers.com
Ask Jeeves	Search engine that uses a user-friendly question format. Provides simultaneous search results from other search engines as well (e.g., Excite, Yahoo, AltaVista)	http://www.askjeeves.com

Name of Site	*Content*	*Internet Address*
Vision Project	Information on the profession's vision project	http://www.cpavision.org/horizon
Internet Bulletin for CPAs	CPA tool for Internet sites, discussion groups, and other resources for CPAs	http://www.kentis.com/ib.html
Governmental Accounting Board	Summaries of recent accounting pronouncements and other GASB activities	http://www.gasb.org