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Technical
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1

OTHER
COMPREHENSIVE
BASES OF
ACCOUNTING

Revised 1989

AICPA

American Institute of Certified Public Accountants

NOTICE TO READERS

This book appears as sections 11,100 through 11,700 in the looseleaf AICPA *Financial Statement Preparation Manual* (as of March 1989), which is updated quarterly.

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1

OTHER
COMPREHENSIVE
BASES OF
ACCOUNTING

Revised 1989

William Rea Lalli, CPA, Technical Manager

American Institute of Certified Public Accountants

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PREFACE

Other Comprehensive Bases of Accounting

This book is a revision of *Other Comprehensive Bases of Accounting*, the first in the Technical Information for Practitioners series. Each book in the series is designed to give practical guidance to one aspect of an accounting or audit engagement. This revision also appears as sections 11,100 through 11,700 in the 1989 AICPA *Financial Statement Preparation Manual* (as of March 1989), which is updated quarterly.

This book includes illustrative accountants' reports, financial statement formats, and a limited number of illustrative notes for uncomplicated nonpublic entities that prepare their financial statements on a comprehensive basis of accounting other than generally accepted accounting principles (referred to as an "other comprehensive basis of accounting" or "OCBOA").

The series is a nonauthoritative kit of practice aids. Various formats of financial statement presentation are in use; nevertheless, inclusion of only certain formats in this book is not intended to mean that they are preferable. In addition, these illustrative formats and notes may become of limited use if any complexity is encountered in a particular entity's transactions, because the illustrations deal with relatively uncomplicated entities. Readers are urged to refer directly to the appropriate authoritative pronouncements.

Illustrative financial statement formats are often helpful in developing a consistent style within a firm. However, a full set of illustrative financial statements covering all the situations that are likely to be encountered in practice cannot be compiled because the circumstances of engagements vary widely. The nature of an entity will affect the format and classifications of its financial statements. This book includes different formats and classifications to demonstrate some of the possible variations.

Readers should consider other sources of illustrative financial presentations, such as those in authoritative pronouncements, AICPA audit and accounting guides, NAARS (available as part of the AICPA Total On-Line Tax and Accounting Library [TOTAL]), and library collections of published financial reports.

The sole responsibility for this material rests with the staff of the Technical Information Division. This material has not been approved, disapproved, or otherwise acted upon by the senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board. Comments and suggestions may be addressed to the following:

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FSP Section 11,100

General Comments on Illustrative Financial Statements—Other Comprehensive Bases of Accounting

.01 This book includes illustrative accountants' reports, financial statement formats, and notes on disclosure of accounting policies for entities whose financial statements are prepared on a comprehensive basis of accounting other than generally accepted accounting principles (OCBOA). Additional notes to financial statements that may be appropriate would be comparable with those required under generally accepted accounting principles (GAAP). In practice, some accountants include the statement of cash flows—cash basis or income tax basis among financial statements prepared on comprehensive bases of accounting other than GAAP. Although not required by authoritative pronouncements, a statement of cash flows may be useful to the user of financial statements prepared on a comprehensive basis of accounting other than GAAP. A recommendation of this statement by the practitioner should be based on the specific facts and circumstances of each case. Such statements of cash flows would be comparable with the illustrations in the *Financial Statement Preparation Manual* (FSP), section 2700, and, accordingly, are not presented in this book.

.02 The AICPA Auditing Standards Board has issued Statement on Auditing Standards (SAS) No. 62, *Special Reports* (among other things), to provide practitioners with guidance when expressing an opinion in connection with financial statements prepared in conformity with a comprehensive basis of accounting other than generally accepted accounting principles. The SAS has changed generally accepted auditing standards by—

- Prescribing a new special report form that parallels the form of the auditor's standard report in SAS No. 58, *Reports on Audited Financial Statements*.
- Requiring the auditor's special report to state that the financial statements were prepared in conformity with a comprehensive basis of accounting other than GAAP.
- Clarifying that there is no requirement to describe in the auditor's special report how the presentation differs from presentation in conformity with GAAP.
- Clarifying requirements for issuing a special purpose report on special or incomplete OCBOA presentations.
- Restricting the distribution of reports on financial presentations prepared to comply with a basis of accounting prescribed in a contract or regulatory provision that result in (1) presentations that are not in conformity with GAAP or an Other Comprehensive Basis of Accounting (OCBOA) or (2) incomplete GAAP or OCBOA presentations (except when the auditor's report and related financial presentation are to be filed with a regulatory agency and included in a document that is distributed to the general public).

.03 SAS No. 62 [(AICPA, *Professional Standards*, vol. 1, AU sec. 623) which supersedes previous guidance in SAS No. 14, *Special Reports* (AICPA, *Professional Standards*, vol. 1, AU sec. 621)] addresses the following matters concerning financial statements prepared in accordance with a comprehensive basis of accounting other than GAAP:

- Descriptions of each basis that constitutes a comprehensive basis of accounting other than GAAP (SAS No. 62, paragraph 4 [AICPA, *Professional Standards*, vol. 1, AU sec. 623.04])
- Suitable titles for financial statements prepared on a comprehensive basis of accounting other than GAAP (SAS No. 62, paragraph 7 [AICPA, *Professional Standards*, vol. 1, AU sec. 623.07])
- Reporting by auditors on financial statements prepared in accordance with a comprehensive basis of accounting other than GAAP (SAS No. 62, paragraph 5 [AICPA, *Professional Standards*, vol. 1, AU sec. 623.05])

.04 The description of the cash receipts and disbursements basis in SAS No. 62, paragraph 4c (AICPA, *Professional Standards*, vol. 1, AU sec. 623.04c), includes the following phrase:

. . . modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing income taxes.

That phrase leads to the question of which modifications have “substantial support.” The reply cannot be a simple reference to an authoritative source because the cash basis of accounting and modifications of the cash basis are not formalized in accounting literature as is the accrual basis of accounting. Modifications have evolved through common usage and practice. Ordinarily, a modification would have substantial support (a) if the method is equivalent to the accrual basis of accounting for the particular item and (b) if the method is not illogical (recording revenue on the accrual basis and recording purchases and other costs on the cash basis would be illogical). If modifications of the cash basis of accounting do not have substantial support, the accountant should include an explanatory paragraph and modify the recommended language of the applicable standard report.

.05 If the modifications are so extensive that the cash basis statements are, in the accountant’s judgment, tantamount to financial statements on the accrual basis, the statements should be considered to be on the accrual basis. The accountant should use the applicable standard form of report, modified as appropriate because of departures from generally accepted accounting principles.¹ For example, financial statements that are presented in conformity with generally accepted accounting principles—with the exception that material leases are not capitalized (Statement of Financial Accounting Standards No. 13 [*FASB Current Text*, section L10])—are not considered to be cash basis financial statements.

.06 When financial statements (or specified elements, accounts, or items thereof) have been prepared in conformity with generally accepted accounting principles in prior years, and the entity changes its method of presentation in the current year by preparing its financial statements in conformity with an other comprehensive basis of accounting, the auditor need not follow the reporting guidance in subparagraph 31a of SAS No. 62 concerning reporting a

¹See SAS No. 58, paragraphs 49 through 54 (AICPA, *Professional Standards*, vol. 1, AU sec. 508.49–.54) and Statement on Standards for Accounting and Review Services (SSARS) 1, paragraphs 39 through 41 (AICPA, *Professional Standards*, vol. 2, AR sec. 100.39–.41).

lack of consistency. However, in an audit engagement, the auditor may wish to add an explanatory paragraph to the report to highlight (1) a difference in the basis of presentation from that used in prior years or (2) that another report has been issued on the entity's financial statements prepared in conformity with another basis of presentation (for example, when cash basis financial statements are issued in addition to GAAP financial statements).

.07 These two concepts are illustrated in an example of a report on comparative financial statements in section 11,700.11.

FSP Section 11,200

Description and Explanation of Bases Illustrated

Overview

.01 SAS No. 62, paragraph 4 (AICPA, *Professional Standards*, vol. 1, AU sec. 623.04), describes several common comprehensive bases of accounting other than generally accepted accounting principles, as follows:

- a. A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a government regulatory agency to whose jurisdiction the entity is subject (An example is the basis of accounting that insurance companies use pursuant to the rules of a state insurance commission.)
- b. A basis of accounting that the reporting entity uses or expects to use to file its income tax return for the period covered by the financial statements
- c. The cash receipts and disbursements basis of accounting and modifications of the cash basis having substantial support, such as recording depreciation on fixed assets or accruing income taxes
- d. A definite set of criteria having substantial support that is applied to all material items appearing in financial statements, such as the price-level basis of accounting

.02 Unless the financial statements meet one of the above bases, the auditor should use the standard form of report [see SAS No. 58, *Reports on Audited Financial Statements*, paragraph 8 (AICPA, *Professional Standards*, vol. 1, AU sec. 508)] modified as appropriate because of a departure from GAAP.

.03 This book includes illustrations of the cash and income tax bases of accounting.

Cash Basis

.04 The cash basis of accounting consists of recording transactions on the basis of cash receipts and disbursements with the results that (a) certain revenue and the related assets are recognized when received rather than when earned and that (b) certain expenses are recognized when paid rather than when the obligation is incurred. The cash basis is usually accompanied by certain modifications that have substantial support, such as capitalizing fixed assets, recognizing debt arising from cash transactions, recording depreciation on fixed assets, and accruing income taxes on cash basis income. When accompanied by these modifications the basis is often described as the *modified cash basis*.

.05 Examples of entities that may use the modified cash basis include professional service organizations and individuals such as certified public accountants, physicians, and attorneys.

.06 The cash basis encompasses the presentation of a summary of cash receipts and disbursements. In this form of presentation, cash receipts from sales, the incurrence of debt, contributions, and so forth, and disbursements for debt repayment, expenses, and the purchase of fixed assets are summarized to show the change in the cash balance for a period. [See section 11,400.16]

.07 Examples of some entities that may use this limited form of cash basis accounting described in the preceding paragraph are estates, trusts, civic ventures, and student activity funds.

Tax Basis

.08 Entities that use the tax basis of accounting are typically either profit-oriented enterprises (such as small, closely held retail and manufacturing companies) for which conversion to GAAP would be costly or partnerships (such as tax shelters) whose partnership agreements require the use of the tax basis of accounting.

FSP Section 11,300

Recommended Measurement and Disclosure Guidelines—Cash Basis

General Comments

.01 The measurement and disclosure guidelines for financial statements presented on the cash basis of accounting are set forth in this section.

Measurement Guidelines

.02 Under the cash basis of accounting, the financial statements generally reflect assets, liabilities, income, and expenses arising from cash transactions, as well as certain accruals and amortizations that have substantial support.

.03 Adjusting one element of the financial statements without adjusting related items may be illogical. (For example, presenting sales on the accrual basis and purchases on the cash basis is illogical. Sales and purchases should be presented on the same basis because of their interrelationship.)

Disclosure Guidelines

General

.04 Each financial statement should include prominent disclosure that it is prepared on the cash basis of accounting. Each page of the financial statements would be enhanced by including, where applicable, a reference to the notes to the financial statements, which are an integral part of the financial statements. One such reference would state that “the accompanying notes are an integral part of the financial statements.” Other wording may also be appropriate.

Significant Accounting Policies

.05 The notes, preferably the first note, to the financial statements should contain a “Summary of Significant Accounting Policies.” This note should describe the cash basis, including any accrual adjustments or modifications, and should disclose but need not quantify material differences between the cash basis and GAAP.

.06 Modifications or adjustments of the cash basis should have substantial support.

Accounting Changes

.07 The nature and effect on income of an accounting change should be disclosed in the period in which the change is made. Accounting changes consist of changes in methods of accounting and changes in accounting estimates.

Business Combinations

.08 In the period in which a business combination occurs, information disclosed should include the following:

- a.* The names and brief descriptions of the acquired or combined companies
- b.* Information about any adjustments made to the carrying bases of the assets and liabilities of any of the companies as a result of the combination, as well as the period for which the results of operations of the acquired or combined companies are included in the statement of revenues and expenses—cash basis
- c.* The consideration given, including the number and type of any shares of stock issued
- d.* Contingent payments, options, and commitments arising from the combination (specified in the related agreement)

Related Party Transactions

.09 The existence of related parties with which the reporting entity has participated in transactions that are material individually or in the aggregate, and the nature and amounts of the transactions should be disclosed.

Pension Plans and Commitments and Contingencies

.10 The existence and nature of a pension plan, and material commitments and contingencies should be disclosed.

Subsequent Events

.11 The nature and financial effects of material events and transactions that occurred subsequent to the balance sheet date and prior to the issuance of the financial statements should be disclosed.

Assets and Liabilities

.12 Information disclosed on assets and liabilities should include these items:

- a.* Restricted cash, segregated from cash available for current operations (with a description of the nature of the restriction)
- b.* The aggregate market value of marketable securities
- c.* Accounts and notes receivable from officers, employees, and affiliates (presented separately with disclosure of the effective interest rate on notes receivable)

- d.* The major classes of property, plant, and equipment; depreciation expense for the period; the method(s) used in computing depreciation; and the aggregate, accumulated depreciation (a lessor should make separate disclosure of leased property)
- e.* For a lessee, a general description of leasing arrangements and lease payments for the next five years
- f.* Interest rates, maturities, and collateral of notes payable and other debt, including a five-year schedule of maturity

Stockholders' Equity

.13 The financial statements should disclose information on stockholders' equity as follows:

- a.* For each class of stock, the number of shares authorized, issued, and outstanding; the par or stated value; and, in summary form, the pertinent rights and privileges of each outstanding class (if more than one class is outstanding)
- b.* The existence of stock option and stock purchase plans
- c.* Restrictions on the payment of dividends
- d.* Changes for the period in the separate components of stockholders' equity

Income and Expense

.14 The financial statements should disclose the following information relating to income and expense:

- a.* An explanation, where applicable, if income tax is not provided or if there is an unusual ratio of income tax to income before income taxes
- b.* The amount of tax credits
- c.* The amount of unused net operating loss and tax credit carryovers, together with their expiration dates
- d.* The nature and financial effects of material events or transactions that are unusual in nature or infrequent in occurrence

FSP Section 11,400

Illustrative Financial Statements— Cash Basis

General Comments

.01 This section presents illustrative financial statements prepared on the cash basis. The titles used differ from those used for financial statements based on generally accepted accounting principles because both SAS No. 62 and SSARS 1 indicate that titles of financial statements prepared on an other comprehensive basis of accounting should differ from those used for GAAP statements.

.02 A method of reporting under the cash basis limited to a statement of cash receipts and disbursements showing only the changes in the cash balances is presented in paragraphs .16 and .17.

[Illustrative financial statements are on the following pages.]

Cash Basis—Financial Statements (a Corporation)

.03 Statements of Assets and Liabilities—Cash Basis

Y and Z Corporation
Statements of Assets and Liabilities—Cash Basis
December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Assets		
Current assets		
Cash	\$ X,XXX	\$ X,XXX
Due from officer (Note 2)*	<u>—</u>	<u>X,XXX</u>
Total current assets	<u>X,XXX</u>	<u>X,XXX</u>
Property and equipment, at cost (Note 1)		
Furniture	XX,XXX	XX,XXX
Office equipment	XX,XXX	XX,XXX
Leasehold improvements	<u>X,XXX</u>	<u>X,XXX</u>
	XX,XXX	XX,XXX
Less accumulated depreciation and amortization (Note 1)	<u>(X,XXX)</u>	<u>(X,XXX)</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>
Liabilities		
Current liabilities		
Loan payable to bank, current portion (Note 3)	\$ X,XXX	\$ X,XXX
Note payable to officer (Note 2)*	<u>X,XXX</u>	<u>—</u>
Total current liabilities	<u>X,XXX</u>	<u>X,XXX</u>
Loan payable to bank less current portion included above (Note 3)	<u>X,XXX</u>	<u>X,XXX</u>
	<u>X,XXX</u>	<u>X,XXX</u>
Stockholders' Equity		
Common stock, \$XXX par value, authorized XXX number of shares, issued and outstanding XXX shares		
	X,XXX	X,XXX
Additional paid-in capital	XX,XXX	XX,XXX
Retained earnings—cash basis	<u>X,XXX</u>	<u>X,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

The accompanying notes are an integral part of the financial statements.

*If the promissory notes are continuously renewed at the due date, the accounts should be classified out of the current asset or liability section.

.04 Statements of Revenues and Expenses, and Retained Earnings—Cash Basis

Y and Z Corporation
 Statements of Revenues and Expenses,
 and Retained Earnings—Cash Basis
 For the Years Ended December 31, 19X2 and 19X1

	<i>19X2</i>	<i>19X1</i>
Revenues		
Operating revenues	\$ XX,XXX	\$ XX,XXX
Miscellaneous	X,XXX	X,XXX
	XXX,XXX	XXX,XXX
Expenses		
Salaries and bonuses	XX,XXX	XX,XXX
Advertising	XX,XXX	XX,XXX
Rent (Note 5)	X,XXX	X,XXX
Depreciation and amortization (Note 1)	X,XXX	X,XXX
State and local income taxes paid	X,XXX	X,XXX
Federal income taxes paid (Notes 1 and 4)	XX,XXX	XX,XXX
Other expenses paid	X,XXX	X,XXX
	XXX,XXX	XXX,XXX
Excess of revenues over expenses	XX,XXX	XX,XXX
Retained earnings—cash basis		
Balance, beginning of year	X,XXX	X,XXX
	XX,XXX	XX,XXX
Less cash dividends paid during the year	(XX,XXX)	(XX,XXX)
Balance, end of year	\$ X,XXX	\$ X,XXX

The accompanying notes are an integral part of the financial statements.

.05 Notes to Financial Statements—Cash Basis

Y and Z Corporation Notes to Financial Statements—Cash Basis

Note 1—Summary of Significant Accounting Policies

- Principles of Accounting

The Company prepares its financial statements on the cash basis but includes depreciation and amortization of capitalized assets. Under this basis, revenues are recognized when collected rather than when earned, and expenses are recognized when paid rather than when incurred. Consequently, accounts receivable due from customers, amounts due vendors and suppliers, and the unpaid portion of taxes at December 31, 19X2 and 19X1, are not included in the financial statements.

- Property and Equipment

If an expenditure results in an asset having an estimated useful life that extends beyond the year of acquisition, the expenditure is capitalized. Furniture, office equipment, and leasehold improvements are recorded at cost. Depreciation on furniture and office equipment is provided on the double declining-balance method over the estimated useful lives of the assets. Amortization of leasehold improvements is provided on the straight-line method over the term of the lease or the estimated useful lives of the improvements, whichever is shorter.

- Income Taxes

Income taxes are recognized as an expense when paid. Income taxes incurred are determined on a cash receipts and disbursements method. Investment tax credits are accounted for as a reduction of federal income taxes in the period the benefit is realized.

Note 2—Transactions With Related Parties

At December 31, 19X1, Officer A owed \$X,XXX to the Company. This amount was repaid with interest at 10 percent per annum. During the current year, the Company borrowed \$X,XXX from Officer B in exchange for a promissory note due November 30, 19X3, bearing interest at 10 percent per annum.

Note 3—Loan Payable to Bank

This debt consisted of the following:

	<i>December 31, 19X2</i>	<i>December 31, 19X1</i>
Loan payable, bank		
Due in quarterly installments		
of \$X,XXX until December 31,		
19Y2, plus interest at XX%	\$XX,XXX	\$XX,XXX
Less current maturities	<u>(X,XXX)</u>	<u>(X,XXX)</u>
Long-term portion	<u>\$ X,XXX</u>	<u>\$ X,XXX</u>

Long-term debt matures in the next five years as follows:

19X3	\$X,XXX
19X4	X,XXX
19X5	X,XXX
19X6	X,XXX
19X7	<u>X,XXX</u>
	<u>\$X,XXX</u>

Note 4—Income Taxes

The Company benefited from investment tax credits of \$X,XXX in 19X2 and \$X,XXX in 19X1. At December 31, 19X2, investment tax credit carryforwards of \$XX,XXX are available to be applied against future taxable income. The amounts expire as follows:

<i>Expiration Year Ending</i>	<i>Investment Tax Credit Carryovers</i>
19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 5—Leases

The Company leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X2, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 6—Contingencies

The Company is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Company's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Company's financial position.

The Internal Revenue Service has examined the Company's income tax returns through 19X0, or the period during which such returns could be examined has expired. No examinations were under way or completed during 19X2.

Cash Basis—Financial Statements (a Partnership)

.06 Statements of Assets and Liabilities—Cash Basis

Alpha and Bravo, a Partnership
Statements of Assets and Liabilities—Cash Basis
December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Assets		
Current assets		
Cash	\$XX,XXX	\$XX,XXX
U.S. treasury bill, at cost which approximates market	<u>XX,XXX</u>	<u>XX,XXX</u>
Total current assets	<u>XX,XXX</u>	<u>XX,XXX</u>
Property and equipment, at cost (Note 1)		
Furniture and equipment	XX,XXX	XX,XXX
Law books	XX,XXX	XX,XXX
Leasehold improvements	<u>XX,XXX</u>	<u>XX,XXX</u>
	XX,XXX	XX,XXX
Less accumulated depreciation and amortization (Note 1)	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Total assets	<u><u>\$XX,XXX</u></u>	<u><u>\$XX,XXX</u></u>
Liabilities and Partners' Capital		
Current liabilities		
Current portion of note payable (Note 2)	\$XX,XXX	\$XX,XXX
Payroll taxes withheld and accrued	XX,XXX	XX,XXX
Client advances	XX,XXX	XX,XXX
Pension contribution payable	<u>XX,XXX</u>	<u>XX,XXX</u>
Total current liabilities	<u>XX,XXX</u>	<u>XX,XXX</u>
Note payable due April 30, 19X8, less current portion included above (Note 2)	<u>XX,XXX</u>	<u>XX,XXX</u>
Total liabilities	<u>XX,XXX</u>	<u>XX,XXX</u>
Partners' capital	<u>XX,XXX</u>	<u>XX,XXX</u>
Total liabilities and partners' capital	<u><u>\$XX,XXX</u></u>	<u><u>\$XX,XXX</u></u>

The accompanying notes are an integral part of the financial statements.

.07 Statements of Revenues and Expenses—Cash Basis

Alpha and Bravo, a Partnership
 Statements of Revenues and Expenses—Cash Basis
 For the Years Ended December 31, 19X2 and 19X1

	<i>19X2</i>	<i>19X1</i>
Revenues		
Professional fees	\$XXX,XXX	\$XXX,XXX
Interest	X,XXX	X,XXX
Other	X,XXX	X,XXX
Gain on involuntary conversion (Note 6)	—	X,XXX
	XXX,XXX	XXX,XXX
Expenses		
Salaries		
Professional	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX
Payroll taxes		
Professional	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX
Pension (Note 4)		
Professional	X,XXX	X,XXX
Other	X,XXX	X,XXX
Group insurance		
Professional	XX,XXX	XX,XXX
Other	XX,XXX	XX,XXX
Insurance—general	XX,XXX	XX,XXX
Outside professional services	XX,XXX	XX,XXX
Rent (Note 3)	XX,XXX	XX,XXX
Office supplies and expense	XX,XXX	XX,XXX
Telephone	XX,XXX	XX,XXX
Dues	XX,XXX	XX,XXX
Subscriptions and books	XX,XXX	XX,XXX
Travel and entertainment	XX,XXX	XX,XXX
Equipment rental	XX,XXX	XX,XXX
Maintenance and repairs	XX,XXX	XX,XXX
Depreciation and amortization (Note 1)	XX,XXX	XX,XXX
Use tax	XX,XXX	XX,XXX
Interest	XX,XXX	XX,XXX
Continuing legal education	XX,XXX	XX,XXX
Utilities	XX,XXX	XX,XXX
Miscellaneous	XX,XXX	XX,XXX
	XXX,XXX	XXX,XXX
Excess of revenues over expenses	\$XXX,XXX	\$XXX,XXX

The accompanying notes are an integral part of the financial statements.

.08 Statements of Changes in Partners' Capital— Cash Basis

Alpha and Bravo, a Partnership
Statements of Changes in Partners' Capital—Cash Basis
For the Years Ended December 31, 19X2 and 19X1

	<u>Alan B.</u> <u>Alpha</u>	<u>Bertrand</u> <u>S. Bravo</u>	<u>Cynthia</u> <u>Q. Charlie</u>	<u>Total</u>
Balance, January 1, 19X1	\$XX,XXX	\$XX,XXX	\$XX,XXX	\$XX,XXX
19X1				
Excess of revenues over expenses	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Decreases in equity				
Withdrawals	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Contribution to pension fund*	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Total decreases	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Balance, December 31, 19X1	XX,XXX	XX,XXX	XX,XXX	XX,XXX
19X2				
Excess of revenues over expenses	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Decreases in equity				
Withdrawals	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Contribution to pension fund*	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Total decreases	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Balance, December 31, 19X2	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

The accompanying notes are an integral part of the financial statements.

*This represents one of the reporting alternatives available. Some partnerships may prefer to include partners' salaries and pension benefits among expenses for financial reporting purposes. The reporting classification of partners' salaries and pension benefits would be based on the specific facts and circumstances of each case. Where the facts and circumstances do not require inclusion in expenses for financial reporting purposes, some partnerships would combine partners' salaries and pension benefits with other withdrawals and reflect only one decrease in equity.

.09 Notes to Financial Statements—Cash Basis

Alpha and Bravo, a Partnership Notes to Financial Statements—Cash Basis

Note 1—Summary of Significant Accounting Policies

- **Principles of Accounting**

The Company prepares its financial statements on the cash basis but includes depreciation and amortization of capitalized assets, liabilities for payroll withholdings, and accrual of payroll taxes and pension plan contributions. Under this basis, revenues are recognized when collected rather than when earned, and expenses are generally recognized when paid rather than incurred. Consequently, the financial statements do not include accounts receivable due from clients, amounts due vendors and suppliers, and prepaid expenses and liabilities for accrued expenses other than those described above as of December 31, 19X2 and 19X1.

- **Property and Equipment**

If an expenditure results in an asset having an estimated useful life that extends beyond the year of acquisition, the expenditure is capitalized. Furniture, equipment, law books, and leasehold improvements are recorded at cost. Depreciation of furniture, equipment, and law books is provided on the double declining-balance method over the estimated useful lives of the assets. Amortization of leasehold improvements is provided on the straight-line method over the term of the lease or the estimated useful lives of the improvements, whichever is shorter.

- **Income Taxes**

The Company is not subject to income taxes as a separate entity. Taxes on income of the partnership are determined by the individual circumstances of each partner and based on the individual income tax returns of the partners. Consequently, partnership excess of revenues over expenses is presented without a provision for taxes on income.

Note 2—Note Payable

Note payable consisted of the following:

	<i>December 31,</i> <u>19X2</u>	<i>December 31,</i> <u>19X1</u>
Note payable, bank		
Due in quarterly installments of \$X,XXX until April 30, 19X8, plus interest at XX%	\$XX,XXX	\$XX,XXX
Less current maturities	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Long-term portion	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

Long-term debt maturing in the next five years consists of the following:

19X3	\$XX,XXX
19X4	XX,XXX
19X5	XX,XXX
19X6	XX,XXX
19X7	<u>XX,XXX</u>
	<u>\$XX,XXX</u>

Note 3—Leases

The Company leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X2, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 4—Pension Plan

The Company maintains a defined benefit pension plan that covers substantially all employees. The pension plan expense was \$X,XXX in 19X2 and \$X,XXX in 19X1. The pension plan contribution was in accordance with the requirements of the pension plan trustee.

Note 5—Contingencies

The Company is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Company's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Company's financial position.

The Internal Revenue Service has examined the Company's income tax returns through 19X0, or the period during which such returns could be examined has expired. No examinations were under way or completed during 19X2.

Note 6—Unusual Item

Certain of the Company's assets were destroyed by fire on September 3, 19X1. The gain, recorded as a separate item in the income statement, represents the difference between the insurance proceeds received and the depreciated cost of the assets.

Cash Basis—Financial Statements (a Professional Corporation)

.10 Statements of Assets and Liabilities—Cash Basis

M, O and D, P.C.
Statements of Assets and Liabilities—Cash Basis
December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Assets		
Current assets		
Cash	\$ XX,XXX	\$ XX,XXX
U.S. treasury bill, at cost, which approximates market	XX,XXX	XX,XXX
Total current assets	<u>XX,XXX</u>	<u>XX,XXX</u>
Equipment and leasehold improvements, at cost (Notes 1 and 3)		
Dental equipment	XXX,XXX	XXX,XXX
Office equipment	XX,XXX	XX,XXX
Leasehold improvements	XX,XXX	XX,XXX
	<u>XXX,XXX</u>	<u>XXX,XXX</u>
Less, accumulated depreciation and amortization	<u>(X,XXX)</u>	<u>(X,XXX)</u>
Net equipment and leasehold improvements	<u>XX,XXX</u>	<u>XX,XXX</u>
Due from stockholder (Note 2)	<u>X,XXX</u>	<u>X,XXX</u>
Total assets	<u>\$XXX,XXX</u>	<u>\$XXX,XXX</u>
Liabilities		
Current liabilities		
Current portion of installment loan (Note 3)	\$ XX,XXX	\$ XX,XXX
Payroll taxes and withholdings	X,XXX	X,XXX
Accrued federal income taxes	X,XXX	X,XXX
Accrued profit sharing	X,XXX	X,XXX
Total current liabilities	<u>XX,XXX</u>	<u>XX,XXX</u>
Installment loan, less current portion included above (Note 3)	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Stockholders' equity		
Common stock \$10 par value; 1000 shares authorized; issued and outstanding 300 shares in 19X2, 200 shares in 19X1	X,XXX	X,XXX
Additional paid-in capital	XX,XXX	XX,XXX
Retained earnings—cash basis	XX,XXX	XX,XXX
Total stockholders' equity	<u>XX,XXX</u>	<u>XX,XXX</u>
Total liabilities and stockholders' equity	<u>\$XXX,XXX</u>	<u>\$XXX,XXX</u>

The accompanying notes are an integral part of the financial statements.

.11 Statements of Revenues and Expenses, and Retained Earnings—Cash Basis

M, O and D, P.C.
 Statements of Revenues and Expenses, and
 Retained Earnings—Cash Basis
 For the Years Ended December 31, 19X2 and 19X1

	19X2	19X1
Revenues		
Fees	\$XXX,XXX	\$XXX,XXX
Interest income	X,XXX	X,XXX
	XXX,XXX	XXX,XXX
Expenses		
Dental supplies	X,XXX	X,XXX
Depreciation and amortization (Note 1)	X,XXX	X,XXX
Dues and licenses	XXX	XXX
Insurance	X,XXX	X,XXX
Interest	X,XXX	X,XXX
Laboratory fees	X,XXX	X,XXX
Maintenance and repairs—dental equipment	X,XXX	X,XXX
Maintenance and repairs—other	XXX	XXX
Medical reimbursement plan	X,XXX	X,XXX
Miscellaneous	X,XXX	X,XXX
Office supplies and expense	X,XXX	X,XXX
Pension (Note 6)	X,XXX	X,XXX
Profit sharing (Note 6)	X,XXX	X,XXX
Professional fees	X,XXX	X,XXX
Professional meetings and seminars	X,XXX	X,XXX
Rent (Note 5)	X,XXX	X,XXX
Salaries—officers	XXX,XXX	XXX,XXX
Salaries—other	XX,XXX	XX,XXX
Taxes—payroll	X,XXX	X,XXX
Taxes—other	X,XXX	X,XXX
Telephone	X,XXX	X,XXX
Travel	XXX	XXX
Utilities	X,XXX	X,XXX
	XXX,XXX	XXX,XXX
Excess of revenues over expenses before income		
taxes	X,XXX	X,XXX
Income taxes (Note 4)	X,XXX	X,XXX
Net earnings—cash basis	X,XXX	X,XXX
Retained earnings—cash basis		
Balance, beginning of year	XX,XXX	XX,XXX
Less cash dividends paid during the year	(X,XXX)	(X,XXX)
Balance, end of year	\$ XX,XXX	\$ XX,XXX

The accompanying notes are an integral part of the financial statements.

.12 Notes to Financial Statements—Cash Basis

M, O and D, P.C.
Notes to Financial Statements—Cash Basis

Note 1—Summary of Significant Accounting Policies

- Principles of Accounting

The Company prepares its financial statements on the cash basis but includes depreciation and amortization of capitalized assets, liabilities for payroll withholdings, and accruals of payroll taxes, profit sharing contributions, and income taxes payable. Under this basis, revenues are recognized when collected rather than when earned, and expenses are generally recognized when paid rather than when incurred. Consequently, accounts receivable due from patients, trade accounts payable, and accrued expenses other than those mentioned above are not included in the financial statements as of December 31, 19X2, and 19X1.

- Equipment and Leasehold Improvements

If an expenditure results in an asset having an estimated useful life that extends beyond the year of acquisition, the expenditure is capitalized and depreciated or amortized over the estimated useful life of the asset. Equipment and leasehold improvements are recorded at cost. Depreciation of equipment is provided on the double declining-balance method over the estimated useful lives of the assets. Amortization of leasehold improvements is provided on the straight-line method over the term of the lease or the estimated useful lives of the improvements, whichever is shorter.

- Income Taxes

Investment tax credits are accounted for as a reduction of federal income taxes in the period the tax benefit is realized.

Note 2—Transactions With Related Parties

The amount due from the stockholder bears interest at 10 percent per annum and is due November 30, 19X4.

Note 3—Installment Loan

This loan consisted of the following:

	<u>December 31,</u> <u>19X2</u>	<u>December 31,</u> <u>19X1</u>
Loan payable, bank		
Due in quarterly installments of \$X,XXX until December 31, 19Y2, plus interest at XX%, collateralized by dental equipment	\$XX,XXX	\$XX,XXX
Less current maturities	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Long-term portion	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

Long-term debt maturing in the next five years consists of the following:

19X3	\$XX,XXX
19X4	XX,XXX
19X5	XX,XXX
19X6	XX,XXX
19X7	<u>XX,XXX</u>
	<u>\$XX,XXX</u>

Note 4—Income Taxes

The Company benefited from investment tax credits of \$X,XXX in 19X2 and \$X,XXX in 19X1. At December 31, 19X2, investment tax credit carryforwards of \$XX,XXX are available to be applied against future taxable income. The amounts expire as follows:

<u>Expiration Year Ending</u>	<u>Investment Tax Credit Carryovers</u>
19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 5—Leases

The Company leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X2, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 6—Pension Plans and Commitments

The Company has a profit sharing plan that covers nonunion employees.

The Company maintains a defined benefit pension plan that covers substantially all union employees. The pension plan expense was \$X,XXX in 19X2 and \$X,XXX in 19X1. The pension plan contribution was in accordance with the requirements of the pension plan trustee.

Note 7—Contingencies

The Company is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Company's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Company's financial position.

The Internal Revenue Service has examined the Company's income tax returns through 19X0, or the period during which such returns could be examined has expired. No examinations were under way or completed during 19X2.

Cash Basis—Financial Statements (an S Corporation)

.13 Statements of Assets and Liabilities—Cash Basis

S Incorporated
Statements of Assets and Liabilities—Cash Basis
December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Assets		
Current assets		
Cash	\$ X,XXX	\$ X,XXX
Due from officer (Note 2)	<u>—</u>	<u>X,XXX</u>
Total current assets	<u>X,XXX</u>	<u>X,XXX</u>
Property and equipment, at cost (Notes 1 and 3)		
Furniture	XX,XXX	XX,XXX
Office equipment	XX,XXX	XX,XXX
Leasehold improvements	<u>X,XXX</u>	<u>X,XXX</u>
	XX,XXX	XX,XXX
Less, accumulated depreciation and amortization (Note 1)	<u>(X,XXX)</u>	<u>(X,XXX)</u>
Total assets	<u><u>\$XX,XXX</u></u>	<u><u>\$XX,XXX</u></u>
Liabilities		
Current liabilities		
Note payable to bank (Note 3)	\$XX,XXX	\$XX,XXX
Accrued state and local income taxes (Note 1)	<u>X,XXX</u>	<u>—</u>
Total current liabilities	<u>X,XXX</u>	<u>X,XXX</u>
Note payable to bank, less current portion included above (Note 3)	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Stockholders' equity		
Common stock, \$XXX par value, authorized XXX num- ber of shares, issued and outstanding XXX shares	X,XXX	X,XXX
Additional paid-in capital	XX,XXX	XX,XXX
Retained earnings—cash basis (Note 1)	<u>X,XXX</u>	<u>X,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Total liabilities and stockholders' equity	<u><u>\$XX,XXX</u></u>	<u><u>\$XX,XXX</u></u>

The accompanying notes are an integral part of the financial statements.

.14 Statements of Revenues and Expenses, and Retained Earnings—Cash Basis

S Incorporated
 Statements of Revenues and Expenses,
 and Retained Earnings—Cash Basis
 For the Years Ended December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Revenues		
Operating revenue	\$XX,XXX	\$XX,XXX
Miscellaneous	<u>X,XXX</u>	<u>X,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Expenses		
Salaries and bonuses	XX,XXX	XX,XXX
Advertising	XX,XXX	XX,XXX
Rent (Note 4)	X,XXX	X,XXX
Depreciation and amortization (Note 1)	X,XXX	X,XXX
Other	<u>X,XXX</u>	<u>X,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Excess of revenues over expenses before provision for income taxes	XX,XXX	XX,XXX
Provision for state and local income taxes (Note 1)	<u>X,XXX</u>	<u>X,XXX</u>
Excess of revenues over expenses	XX,XXX	XX,XXX
Retained earnings—cash basis (Note 1)		
Balance, beginning of year	<u>X,XXX</u>	<u>X,XXX</u>
	<u>XX,XXX</u>	<u>XX,XXX</u>
Less dividends (Note 6)	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Balance, end of year	<u>\$ X,XXX</u>	<u>\$ X,XXX</u>

The accompanying notes are an integral part of the financial statements.

.15 Notes to Financial Statements—Cash Basis

S Incorporated Notes to Financial Statements—Cash Basis

Note 1—Summary of Significant Accounting Policies

- **Principles of Accounting**

The Company prepares its financial statements on the cash basis but includes depreciation and amortization of capitalized assets, and accrued liabilities for state and local income taxes payable. Under this basis, revenues are recognized when collected rather than when earned, and expenses are generally recognized when paid rather than when incurred. Consequently, commissions receivable, trade accounts payable, prepaid expenses, and certain accrued expenses at December 31, 19X2 and 19X1, are not included in the financial statements.

- **Property and Equipment**

If an expenditure results in an asset having an estimated useful life that extends beyond the year of acquisition, the expenditure is capitalized and depreciated or amortized over the estimated useful life of the asset. Property, equipment, and leasehold improvements are recorded at cost. Depreciation of property and equipment is provided on the straight-line method over the estimated useful lives of the assets. Amortization of leasehold improvements is provided on the straight-line method over the term of the lease or the estimated useful lives of the improvements, whichever is shorter.

- **Income Taxes**

The Company has elected by unanimous consent of its stockholders to be taxed under the provisions of Subchapter S of the Internal Revenue Code. Under those provisions, the Company does not pay federal corporate income taxes on its taxable income. [S Incorporated is allowed no net operating loss carryover or carryback as a deduction.*] Instead, the stockholders are liable for individual federal income taxes on their respective shares of the Company's taxable income. [The stockholders include their respective shares of the Company's net operating loss in their individual income tax returns.*]

Note 2—Transactions With Related Parties

At December 31, 19X1, Officer A owed \$X,XXX to the Company. This amount was repaid with interest at 10 percent per annum.

Note 3—Note Payable to Bank

This debt consisted of the following:

	<i>December 31,</i> <u>19X2</u>	<i>December 31,</i> <u>19X1</u>
Note payable, bank		
Due in quarterly installments of \$X,XXX until December 31, 19Y2, plus interest at XX%, collateralized by office equipment.	\$XX,XXX	\$XX,XXX
Less current maturities.	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Long-term portion	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

*Additional illustrative language in the event of an operating loss.

Long-term debt maturing in the next five years consists of the following:

19X3	\$XX,XXX
19X4	XX,XXX
19X5	XX,XXX
19X6	XX,XXX
19X7	<u>XX,XXX</u>
	<u>\$XX,XXX</u>

Note 4—Leases

The Company leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X2, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 5—Contingencies

The Company is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Company's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Company's financial position.

The Internal Revenue Service has examined the Company's income tax returns through 19X0, or the period during which such returns could be examined has expired. No examinations were under way or completed during 19X2.

Under certain circumstances, the Company's election can be retroactively terminated by the Internal Revenue Service and the Company may be required to pay federal income taxes.

Note 6—Dividends

A dividend of \$XX,XXX was declared and paid on February 15, 19X2.*

*S Corporations often pay substantial dividends after the end of the year. A dividend declared before the end of the year generally would be recorded as a liability and shown separately in the statement of assets and liabilities. A dividend declared after the end of the year would be disclosed as a subsequent event in conformity with FASB Statement No. 5, paragraph 11 (*FASB Current Text*, sec. C59.112) and SAS No. 1, section 560.01-.09 (AICPA, *Professional Standards*, vol. 1, AU sec. 560.01-.09).

Cash Basis—Financial Statement (Not-for-Profit)

.16 Statement of Cash Receipts and Disbursements

ABC Charity—Dinner Fund
Statement of Cash Receipts and Disbursements
For the Year Ended December 31, 19X5

Cash receipts		
Contributions	\$XX,XXX	
Sales of raffle tickets	XX,XXX	
Advances from ABC Charity General Fund	X,XXX	
Interest on passbook savings accounts	<u>XXX</u>	
Total cash receipts.....		\$XX,XXX
Cash disbursements		
Food purchases	\$XX,XXX	
Refund of advances from ABC Charity General Fund	X,XXX	
Advertising	X,XXX	
Professional fees	X,XXX	
Postage	X,XXX	
Travel	X,XXX	
Telephone	X,XXX	
Rental (Note 2)	X,XXX	
Raffle prizes	X,XXX	
Contribution to (Name of Recipient)	<u>XX,XXX</u>	
Total cash disbursements.....		<u>XX,XXX</u>
Excess of cash receipts over cash disbursements.....		XX,XXX
Cash balance, January 1, 19X5		<u>X,XXX</u>
Cash balance, December 31, 19X5		<u>\$ X,XXX</u>
Cash balance as of December 31, 19X5, is accounted for as follows:		
Demand deposit, Tenth National Bank.....		\$ XXX
Passbook deposit, Penny Savings Bank.....		<u>X,XXX</u>
Total.....		<u>\$ X,XXX</u>

The accompanying notes are an integral part of the financial statements.

.17 Notes to Statement of Cash Receipts and Disbursements

ABC Charity–Dinner Fund Notes to Statement of Cash Receipts and Disbursements

Note 1—Accounting Policies

The ABC Charity–Dinner Fund financial statement presents cash receipts and cash disbursements in accordance with the resolution of April 1, 19XX, of the Board of Governors of ABC Charity. Revenues are not recognized when received and expenses are not recognized when paid; rather the statements of cash receipts and disbursements are summaries of the cash activity of ABC Charity–Dinner Fund and do not present transactions that would be included in financial statements of ABC Charity–Dinner Fund presented on the accrual basis of accounting, as contemplated by generally accepted accounting principles. It is the policy of the ABC Charity–Dinner Fund Committee to have no outstanding advances to or from the ABC Charity–General Fund at year-end.

Note 2—Leases

The Fund leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X5, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X6	\$XX,XXX
19X7	\$XX,XXX
19X8	\$XX,XXX
19X9	\$XX,XXX
19Y0	\$XX,XXX

Note 3—Commitments and Contingencies

The Fund is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Fund's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Fund's financial position.

FSP Section 11,500

Recommended Measurement and Disclosure Guidelines—Income Tax Basis

General Comments

.01 The measurement and disclosure guidelines for material items in financial statements presented on the income tax basis of accounting are set forth in this section. Guidance is provided on the measurement of assets and related revenues as well as liabilities and related expenses that do not enter into taxable income.

Measurement Guidelines

.02 The income tax basis of accounting is based upon the principles and rules for accounting for transactions under the Federal income tax laws and regulations. Few new measurement guidelines need to be established because this method is based upon Federal tax laws. This method covers a range of alternative bases from cash to full accrual, depending on the nature of the taxpayer, and in some circumstances, the taxpayer's elections. It is believed that this basis of accounting is useful to small, nonpublic entities who find that the cost of GAAP financial statements is not beneficial in relation to the needs of likely users. Most users of financial statements can be expected to recognize and understand the nature of the income tax basis.

Nontaxable Revenues

.03 Under the Federal income tax laws, receipts from some sources, such as interest on obligations of state and local governments and proceeds from life insurance policies, are excluded from revenue for income tax purposes. In presenting financial statements on the income tax basis, nontaxable revenues should be recognized when they are received or when they are accruable and should be reported in the statement of revenues and expenses—income tax basis.

Nondeductible Expenses

.04 Costs incurred for some expense items, such as premiums paid on officers' life insurance policies, are not deductible for income tax purposes. In financial statements prepared on the income tax basis of accounting, nondeductible expenses should be reported and charged to expense in the period in which they are incurred. For example, charitable contributions in excess of IRS limitations (pass-through items in S Corporations) and investment interest should be charged to expense in the year incurred. The amounts should be included in the statement of revenues and expenses—income tax basis in the appropriate expense category.

Additional Income Taxes for Prior Years

.05 Additional income taxes for prior years may be assessed as the result of an examination by the Internal Revenue Service (IRS). Two alternative methods may be used to account for additional taxes for prior years:

- a. The amount may be charged to expense in the current period if there are no corresponding adjustments to the balance sheet for expenses capitalized or revenue recognized
- b. The amount may be treated as a prior period adjustment and charged to retained earnings

Either method is considered acceptable in the preparation of financial statements on the income tax basis. The method used should be disclosed in the financial statements.

Adjustments to Balance Sheet for IRS Changes

.06 The IRS may disallow amounts charged to expense in prior years and require those amounts to be capitalized and amortized or may require recognition of previously unreported revenue. Such amounts, net of income tax adjustments, should be treated as prior period adjustments.

Accounting Changes for Tax Purposes

.07 For tax purposes, the effects of an accounting change may be recognized prospectively over a period of ten years. In income tax basis financial statements, the total effect should be recorded in the year of the change and amortized over the ten-year period.

S Corporations

.08 Income of an S Corporation is taxable to its shareholders; consequently, such a corporation may be required to maintain information on distinct classes of retained earnings. However, in financial statements prepared on the income tax basis, S Corporations should report retained earnings as a single amount and should report distributions to stockholders as dividends.

Disclosure Guidelines

General

.09 Each financial statement should include prominent disclosure that it is prepared on the income tax basis of accounting. Each page of the financial statements would be enhanced by including, where applicable, a reference to the notes to the financial statements, which are an integral part of the financial statements. One such reference would state that “the accompanying notes are an integral part of the financial statements.” Other wording may also be appropriate.

Significant Accounting Policies

.10 The notes, preferably the first note, to the financial statements should contain a "Summary of Significant Accounting Policies." The note should disclose the following:

- a.* Whether the basic method of accounting is cash or accrual
- b.* The tax filing status of the entity (if other than a normal taxable corporation)
- c.* That revenues and related assets and expenses and related obligations are recognized when they are reported or deducted for federal income tax purposes
- d.* That nontaxable income and nondeductible expenses are included in the determination of net income
- e.* The nature of any optional tax methods of accounting followed
- f.* The nature of any important judgments or policies necessary for an understanding of the methods of recognizing revenue and allocating costs to current and future periods

This note need not repeat detailed information already presented on the face of the financial statements or elsewhere in the notes to the financial statements. The note should disclose but need not quantify material differences between the income tax basis and generally accepted accounting principles.

.11 Disclosures made in interim financial statements should include information on how inventories and costs of sales were determined. These disclosures also should indicate that deferrals and accruals have been provided only when they would have been provided at year-end and, thus, the statements should not be viewed as an indicator of results for the year.

Accounting Changes

.12 The nature and effect on income of an accounting change should be disclosed in the period in which the change is made. Accounting changes consist of changes in the methods of accounting and changes in accounting estimates.

Business Combinations

.13 In the period in which a business combination occurs, information disclosed should include the following:

- a.* The names and brief descriptions of the acquired or combined companies
- b.* Information about any adjustments made to the carrying basis of the assets and liabilities of any of the companies as a result of the combination and the period for which the results of operations of the acquired or combined companies are included in the statement of revenue and expenses—income tax basis
- c.* The consideration given, including the number and type of any shares of stock issued
- d.* Contingent payments, options, and commitments arising from the combination and specified in the related agreement

Related Party Transactions

.14 The existence of related parties with which the reporting entity has participated in transactions that are material individually or in the aggregate, and the nature and amounts of the transactions should be disclosed.

Pension Plans and Commitments and Contingencies

.15 The existence and nature of a pension plan and material commitments and contingencies should be disclosed.

Subsequent Events

.16 The nature and financial effects of material events and transactions that are unusual in nature or are of infrequent occurrence that occurred subsequent to the balance sheet date and prior to the issuance of the financial statements should be disclosed.

Assets and Liabilities

.17 Information disclosed on assets and liabilities should include these items:

- a.* Restricted cash, segregated from cash available for current operations (with a description of the nature of the restriction)
- b.* The aggregate market value of marketable securities
- c.* Accounts and notes receivable from officers, employees, and affiliates (presented separately with disclosure of the effective interest rate on notes receivable)
- d.* The method of determining inventory cost (for example, LIFO, FIFO)
- e.* The major classes of property, plant, and equipment (including assets recorded under lease purchase agreements); depreciation expense for the period; the method(s) used in computing depreciation; and the aggregate accumulated depreciation (a lessor should make separate disclosure of leased property)
- f.* For a lessee, a general description of leasing arrangements and lease payments for the next five years
- g.* Interest rates, maturities, and collateral of notes payable and other debt, including a five-year schedule of maturity

Stockholders' Equity

.18 The financial statements should disclose information on stockholders' equity as follows:

- a.* For each class of stock, the number of shares authorized, issued, and outstanding; the par or stated value; and, in summary form, the pertinent rights and privileges of each outstanding class (if more than one class is outstanding)
- b.* The existence of stock option and stock purchase plans

- c.* Restrictions on the payment of dividends
- d.* Changes for the period in the separate components of stockholders' equity

Income and Expense

.19 The financial statements should disclose the following information relating to income and expense:

- a.* An explanation, where applicable, if income tax is not provided or if there is an unusual relationship between income before income taxes and income taxes
- b.* The amount of tax credits
- c.* The amount of unused net operating loss and tax credit carryovers, together with their expiration dates
- d.* The nature and financial effects of material events or transactions that are unusual in nature or are of infrequent occurrence

FSP Section 11,600

Illustrative Financial Statements—Income Tax Basis

General Comments

.01 This section presents illustrative financial statements prepared on the income tax basis. The titles used for the financial statements differ from those used for financial statements based on generally accepted accounting principles because both SAS No. 62 and SSARS 1 indicate that titles of financial statements prepared on an other comprehensive basis of accounting should differ from those used for GAAP statements.

[Illustrative financial statements are on the following pages.]

.02 Statements of Assets and Liabilities—Income Tax Basis

ABC Company		
Statements of Assets and Liabilities—Income Tax Basis		
December 31, 19X2 and 19X1		
	<u>19X2</u>	<u>19X1</u>
Assets		
Current assets		
Cash	\$ XX,XXX	\$ XX,XXX
Temporary investments in municipal securities, at cost plus accrued interest (market 19X2, \$XX,XXX, 19X1, \$XX,XXX)	XX,XXX	XX,XXX
Accounts receivable, less allowances for bad debts 19X2, \$X,XXX, 19X1, \$X,XXX (Notes 3 and 5) . . .	XX,XXX	XX,XXX
Installment accounts receivable, net of deferred income 19X2, \$X,XXX, 19X1, \$X,XXX (Note 1)	XX,XXX	XX,XXX
Inventories at LIFO (Notes 1, 2, and 5)	XX,XXX	XX,XXX
Prepaid expenses	<u>XX,XXX</u>	<u>XX,XXX</u>
Total current assets	<u>XX,XXX</u>	<u>XX,XXX</u>
Advances to affiliate (Note 3)	XX,XXX	XX,XXX
Investment in affiliate, at cost (Note 1)	XX,XXX	XX,XXX
Property, plant, and equipment, at cost less accumu- lated depreciation and amortization 19X2, \$X,XXX, 19X1, \$X,XXX (Notes 1, 4, 5, and 8)	XX,XXX	XX,XXX
Cash surrender value of life insurance on officers (face amount \$XXX,XXX)	X,XXX	X,XXX
Total assets	<u>\$XXX,XXX</u>	<u>\$XXX,XXX</u>
Liabilities		
Current liabilities		
Accounts payable	\$ XX,XXX	\$ XX,XXX
Construction loan payable (Note 1)	XX,XXX	XX,XXX
Current maturities of long-term debt	XX,XXX	XX,XXX
Accrued expenses	XX,XXX	XX,XXX
Income taxes payable (Notes 1, 6, and 8)	<u>XX,XXX</u>	<u>XX,XXX</u>
Total current liabilities	<u>X,XXX</u>	<u>X,XXX</u>
Long-term debt, less current maturities (Note 5)	<u>XX,XXX</u>	<u>XX,XXX</u>
Stockholders' equity		
Common stock, \$XX par value, authorized X,XXX shares, issued and outstanding XXX shares	X,XXX	X,XXX
Additional paid-in capital	XX,XXX	XX,XXX
Retained earnings—income tax basis	<u>XX,XXX</u>	<u>XX,XXX</u>
Total stockholders' equity	<u>XX,XXX</u>	<u>XX,XXX</u>
Total liabilities and stockholders' equity	<u>\$XXX,XXX</u>	<u>\$XXX,XXX</u>

The accompanying notes are an integral part of the financial statements.

.03 Statements of Revenues and Expenses—Income Tax Basis

ABC Company
 Statements of Revenues and Expenses—Income Tax Basis
 For the Years Ended December 31, 19X2 and 19X1

	<i>19X2</i>	<i>19X1</i>
Revenues		
Sales, less returns and allowances		
19X2, \$X,XXX, 19X1, \$X,XXX (Note 3)	\$XX,XXX	\$XX,XXX
Deferred income on installment sales	(X,XXX)	(X,XXX)
Deferred income recognized	X,XXX	X,XXX
Dividends received from affiliate	X,XXX	X,XXX
Interest	X,XXX	X,XXX
Gain on sale of building	X,XXX	X,XXX
Nontaxable interest	X,XXX	X,XXX
	XX,XXX	XX,XXX
Expenses (Notes 1 and 4)		
Cost of sales	XX,XXX	XX,XXX
General and administrative	XX,XXX	XX,XXX
Selling	XX,XXX	XX,XXX
Premium on officers' life insurance	X,XXX	X,XXX
	XX,XXX	XX,XXX
Income before federal income taxes	XX,XXX	XX,XXX
Federal income taxes (Notes 1, 6, and 8)	XX,XXX	XX,XXX
Net income—income tax basis	\$XX,XXX	\$XX,XXX

The accompanying notes are an integral part of the financial statements.

.04 Statements of Retained Earnings—Income Tax Basis

ABC Company
Statements of Retained Earnings—Income Tax Basis
For the Years Ended December 31, 19X2 and 19X1

	<u>19X2</u>	<u>19X1</u>
Balance, beginning of year	\$XX,XXX	\$XX,XXX
Net income	XX,XXX	XX,XXX
Less dividends	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Balance, end of year	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

The accompanying notes are an integral part of the financial statements.

.05 Notes to Financial Statements—Income Tax Basis

ABC Company Notes to Financial Statements—Income Tax Basis

Note 1—Summary of Significant Accounting Policies

- **Basis of Accounting**

The accompanying financial statements have been prepared on the accrual method of accounting used for federal income tax purposes. Consequently, as indicated below, certain revenues and expenses are recognized in the determination of income in different reporting periods than they would be if the financial statements were prepared in conformity with generally accepted accounting principles. Although income tax rules are used to determine the timing of the reporting of revenues and expenses, nontaxable revenues and nondeductible expenses are included in the determination of net income.

- **Installment Sales and Related Receivables**

Gross profit on certain installment sales is presented as deferred income in the balance sheet and recognized as income when collected. If the accompanying financial statements were prepared in conformity with generally accepted accounting principles, the gross profit would be recognized when the sale is made and deferred income taxes would be provided for the timing difference between recognition of income for financial reporting purposes and determination of income taxes.

- **Inventories**

Inventories are generally stated at cost determined by the last-in, first-out (LIFO) method, which is not in excess of market.

- **Investment in L Corporation**

The Company's investment in 30 percent of the common stock of L Corporation is stated at cost. Dividends thereon are recognized as income when received. If the investment were presented in conformity with generally accepted accounting principles, it would also include the Company's share of the undistributed earnings of L Corporation since acquisition. The Company's share of the current earnings of L Corporation would be recognized as an increase of the investment and as income when earned by L Corporation. A deferred income tax liability would be provided for any temporary differences between recognition of income for financial reporting purposes and for determination of income taxes. Dividends received from L Corporation would be recognized as a reduction in the investment with related reduction of deferred taxes provided thereon.

- **Property, Plant, and Equipment**

Property, plant, and equipment are recorded at cost. Depreciation of property, plant, and equipment placed in service prior to January 1, 19X1, is provided on the double declining-balance method over the estimated useful lives of the assets. For property, plant, and equipment placed in service after December 31, 19X0, depreciation is based on an accelerated cost recovery system. Interest on the construction loan to finance construction of the combined shopping center and headquarters facility in East Wherever is expensed as incurred. Real estate taxes on that property are also expensed as incurred. The accompanying financial statements would be modified in the following ways had they been prepared in conformity with generally accepted accounting principles. Interest costs and real estate taxes would be capitalized as part of the cost of the asset. Deferred income taxes would be provided thereon for the timing difference between the recognition of such costs as a component of depreciation provided over the estimated useful life of the asset and recognition as a deduction for determination of taxable income.

- **Net Income—Income Tax Basis**

In accordance with the Company's policy, net income—income tax basis includes nontaxable revenue and nondeductible expenses in addition to taxable revenues, deductible expenses, and income taxes.

(Other matters that would be disclosed in the Summary of Significant Accounting Policies include the accounting followed for matters such as involuntary conversions, severance awards, exchanges of similar property, and tax elections that have a material effect on the financial statements.)

Note 2—Inventories

Inventories at December 31, 19X2 and 19X1, consisted of the following:

	<u>19X2</u>	<u>19X1</u>
Raw materials	\$XX,XXX	\$XX,XXX
Work in process	XX,XXX	XX,XXX
Finished goods	<u>XX,XXX</u>	<u>XX,XXX</u>
	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

Note 3—Transactions With Related Parties

Accounts receivable included \$X,XXX at December 31, 19X2, and \$X,XXX at December 31, 19X1, due from L Corporation, an affiliated company, and sales included \$X,XXX in 19X2 and \$X,XXX in 19X1 resulting from transactions with L Corporation.

Advances to affiliate consist of \$XX,XXX, advanced to L Corporation at an effective interest rate of XX percent.

Note 4—Property, Plant, and Equipment

Property, plant, and equipment consisted of the following:

	<u>December 31, 19X2</u>	<u>December 31, 19X1</u>
Land	\$XX,XXX	\$XX,XXX
Building	XX,XXX	XX,XXX
Equipment	XX,XXX	XX,XXX
Leasehold improvements	X,XXX	X,XXX
Construction in process	<u>XX,XXX</u>	<u>XX,XXX</u>
	XX,XXX	XX,XXX
Less accumulated depreciation and amortization	<u>(X,XXX)</u>	<u>(X,XXX)</u>
	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

Depreciation expense was \$X,XXX in 19X2 and \$X,XXX in 19X1.

Note 5—Long-Term Debt

Long-term debt consisted of the following:

	<u>December 31, 19X2</u>	<u>December 31, 19X1</u>
Notes payable, bank		
Due in quarterly installments of \$X,XXX until December 31, 19Y2, plus interest at XX%, collateralized by receivables and inventory	\$XX,XXX	\$XX,XXX
Mortgage payable		
Due in quarterly payments of \$X,XXX until December 31, 19Z2, including interest at XX%, collateralized by land and building	<u>XX,XXX</u>	<u>XX,XXX</u>
	XX,XXX	XX,XXX
Less current maturities	<u>(XX,XXX)</u>	<u>(XX,XXX)</u>
Long-term portion	<u>\$XX,XXX</u>	<u>\$XX,XXX</u>

Long-term debt maturing in the next five years consists of the following:

19X3	\$XX,XXX
19X4	XX,XXX
19X5	XX,XXX
19X6	XX,XXX
19X7	<u>XX,XXX</u>
	<u>\$XX,XXX</u>

Note 6—Income Taxes

The Company benefited from investment tax credits of \$X,XXX in 19X2 and \$X,XXX in 19X1. At December 31, 19X2, there are investment tax credit carryforwards of \$XX,XXX available to be applied against future taxable income. The amounts expire as follows:

<i>Expiration Year</i>	<i>Investment Tax</i>
<i>Ending</i>	<i>Credit Carryovers</i>
19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 7—Leases

The Company leases office space and certain data processing and other equipment under leases for varying terms. At December 31, 19X2, the minimum rental payments under noncancellable leases with a term in excess of one year were as follows:

19X3	\$XX,XXX
19X4	\$XX,XXX
19X5	\$XX,XXX
19X6	\$XX,XXX
19X7	\$XX,XXX

Note 8—Pension Plans and Commitments and Contingencies

The Company has a commitment of \$XX,XXX for completion of a building.

The Company maintains a defined benefit pension plan that covers substantially all employees. The pension plan expense was \$X,XXX in 19X2 and \$X,XXX in 19X1. The pension plan contribution was in accordance with requirements of the pension plan trustee.

The Company is involved in litigation involving a claim for \$XX,XXX, which, in the opinion of the Company's legal counsel, is not expected to result in an award that would have a materially adverse effect on the Company's financial position.

The Internal Revenue Service has examined the Company's income tax returns through 19X0, or the period during which such returns could be examined has expired. No examinations were under way or completed during 19X2.

Note 9—Subsequent Event

In February 19X3, a fire at the Company's plant destroyed \$XX,XXX of inventory. The Company has filed a claim with its insurance carrier for the full amount of the loss.

FSP Section 11,700

Types of Accountants' Reports

Overview

.01 These examples illustrate various audit, review, and compilation reports on financial statements prepared on a comprehensive basis of accounting other than GAAP. It should be noted that the report qualifications applicable to financial statements prepared in accordance with GAAP also apply to OCBOA statements.

.02 Examples that are assembled from illustrative reporting language set forth in Statements on Auditing Standards and Statements on Standards for Accounting and Review Services include citation of the particular source and its location in the AICPA's *Professional Standards*.

Audit Reports

.03 Cash Basis Statements

Independent Auditor's Report

We have audited the accompanying statements of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of revenue collected and expenses paid for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note X, these financial statements were prepared on the basis of cash receipts and disbursements, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X2 and 19X1, and its revenue collected and expenses paid during the years then ended, on the basis of accounting described in Note X.

[Signature]

[Date]

(Source: SAS 62, paragraph 8 [AICPA, *Professional Standards*, vol. 1, AU sec. 623.08])

.04 Income Tax Basis Statements

Independent Auditor's Report

We have audited the accompanying statements of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19X2 and 19X1, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the years then ended. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note X, these financial statements were prepared on the basis of accounting the Partnership uses for income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and capital of ABC Partnership as of December 31, 19X2 and 19X1, and its revenue and expenses and changes in partners' capital accounts for the years then ended, on the basis of accounting described in Note X.

[Signature]

[Date]

(Source: SAS No. 62, paragraph 8 [AICPA, *Professional Standards*, vol. 1, AU sec. 623.08])

Review Reports*

.05 Cash Basis Statements

I (we) have reviewed the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion

*When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles.

regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note X.

.06 Income Tax Basis Statements

I (we) have reviewed the accompanying statements of assets and liabilities—income tax basis of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of revenue and expenses—income tax basis and retained earnings—income tax basis for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

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

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the income tax basis of accounting, as described in Note X.

(Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 [AICPA, Professional Standards, vol. 2, AR sec. 9100.45])

Compilation Reports*

.07 Cash Basis Statements—Full Disclosure

I (we) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

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

(Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 [AICPA, Professional Standards, vol. 2, AR sec. 9100.45])

*When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles.

.08 Cash Basis Statements—Omission of Substantially All Disclosures

I (we) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. The financial statements have been prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

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

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

.09 Income Tax Basis Statements—Full Disclosure

I (we) have compiled the accompanying statements of assets and liabilities—income tax basis of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of revenue and expenses—income tax basis for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

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

.10 Income Tax Basis Statements—Omission of Substantially All Disclosures, With No Reference to Basis

I (we) have compiled the accompanying statements of assets and liabilities—income tax basis of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of revenues and expenses—income tax basis for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. 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.

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

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, revenue, and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

(Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 [AICPA, *Professional Standards*, vol. 2, AR sec. 9100.45])

Other Reports

.11 Report for a Change From Generally Accepted Accounting Principles to an Other Comprehensive Basis of Accounting

Independent Auditor's Report

We have audited the accompanying statements of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19X2 and 19X1, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the years then ended. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and stockholders' equity of XYZ Company as of December 31, 19X2 and 19X1, and its revenue and expenses for the years then ended, on the basis of accounting described in Note X.

As discussed in Note X to the financial statements, in 19X2 the Company adopted the policy of preparing its financial statements on the accrual method of accounting used for Federal income tax purposes; consequently, buildings, with an estimated economic useful life of thirty-five years, are being amortized over fifteen years in accordance with an accelerated cost recovery system provided under the Internal Revenue Code, rather than over the estimated economic useful life of the buildings. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles. The financial statements for 19X1 have been restated on the income tax basis—accrual method of accounting adopted in 19X2.

[Signature]

[Date]

Note: The above represents the concepts referred to in section 11,100.06--07.

.12 Report on Statements of Cash Receipts and Disbursements

Independent Auditor's Report

We have audited the statements of cash receipts and disbursements of ABC Association for the years ended December 31, 19X2 and 19X1. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in Note X, the statements of cash receipts and disbursements are summaries of the cash activity of the Association and do not present transactions that would be included in financial statements of the Association presented on the accrual basis of accounting, as contemplated by generally accepted accounting principles. Accordingly, the accompanying statements are not intended to present financial position or results of operations in conformity with generally accepted accounting principles.

In our opinion, the accompanying statements present fairly, in all material respects, the cash receipts and disbursements of ABC Association for the years ended December 31, 19X2 and 19X1, on the basis of accounting described in Note X.

[Signature]

[Date]

Note: This type of report would be used for the financial statement referred to in section 11,400.

.13 Report on Financial Presentations That Are Incomplete OCBOA

Independent Auditor's Report

We have audited the accompanying statement of net assets sold of ABC Company as of June 8, 19XX. This statement of net assets sold is the responsibility of ABC Company's management. Our responsibility is to express an opinion on the statement of net assets sold based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the statement of net assets sold is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the statement.

An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the statement of net assets sold. We believe that our audit provides a reasonable basis for our opinion.

The accompanying statement was prepared to present the net assets of ABC Company sold to XYZ Corporation pursuant to the purchase agreement described in Note X, and is not intended to be a complete presentation of ABC Company's assets and liabilities.

In our opinion, the accompanying statement of net assets sold presents fairly, in all material respects, the net assets of ABC Company as of June 8, 19XX sold pursuant to the purchase agreement referred to in Note X on the basis of accounting described in Note Y.

This report is intended solely for the information and use of the boards of directors and managements of ABC Company and XYZ Corporation and should not be used for any other purpose.

[Signature]

[Date]

(Source: SAS 62, paragraph 26 [AICPA, Professional Standards, vol. 1, AU sec. 623.26])

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