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American Institute of Certified Public Accountants. Technical Information Division

William Rea Lalli

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June 1990 Edition

**Checklist and Illustrative
Financial Statements for
Personal Financial
Statement Engagements**
A FINANCIAL ACCOUNTING AND
REPORTING PRACTICE AID

AICPA

American Institute of Certified Public Accountants

June 1990 Edition

**Checklist and Illustrative
Financial Statements for
Personal Financial
Statement Engagements**
A FINANCIAL ACCOUNTING AND
REPORTING PRACTICE AID

Prepared by

**William Rea Lalli, CPA
Technical Manager
Technical Information Division**

The Checklist and Illustrative Financial Statements for Personal Financial Statement Engagements has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants, or the Financial Accounting Standards Board and has no official or authoritative status.

American Institute of Certified Public Accountants

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CHECKLIST AND ILLUSTRATIVE FINANCIAL STATEMENTS
FOR PERSONAL FINANCIAL STATEMENT ENGAGEMENTS

The accounting and reporting checklist and illustrative financial statements in this book have been developed by the staff of the Technical Information Division of the AICPA as a nonauthoritative practice aid. Readers should be aware of the following:

- o The accounting and reporting checklist and illustrative financial statements have been updated to include FASB Statements through No. 105 and AICPA Statements of Position through No. 90-4. The accounting and reporting checklist and illustrative financial statements should be modified, as appropriate, for subsequent pronouncements. In determining the applicability of a pronouncement, its effective date should be considered.

- o The accounting and reporting checklist and illustrative financial statements should be used by or under the supervision of persons having adequate technical training and proficiency in the application of generally accepted accounting principles, generally accepted auditing standards, and statements on standards for accounting and review services.

- o The checklist and illustrative financial statements may not be all-inclusive. The referenced standards should be reviewed if clarification is desired as to whether the accounting or reporting item is required or suggested, and to what extent the item is relevant to the standards in question.

Users of this book are urged to refer directly to the existing, authoritative pronouncements when possible. If you have any questions, please call the AICPA Technical Hotline (see back cover).

John Graves
Director
Technical Services

CHECKLIST AND ILLUSTRATIVE FINANCIAL STATEMENTS
FOR PERSONAL FINANCIAL STATEMENT ENGAGEMENTS

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INTRODUCTION

General Comments on Personal Financial Statements

Personal financial statements are financial statements of an individual or a group of related individuals (a family unit). They are often prepared to formally organize and plan one's financial affairs in general. Specific applications include preparing personal financial statements for obtaining credit, income tax planning, retirement planning, gift and estate planning and for public disclosure purposes.

The Need for Guidance

As one of the results of the unprecedented growth in the economy over the past years, there are more users of personal financial statements. These users want information to rely on in decision-making in order to grant credit, to assess the financial activities of individuals, to assess the financial affairs of public officials and candidates for public office, and other similar purposes.

Relationship to Other Literature

In 1968, the AICPA first issued its industry audit guide entitled, Audits of Personal Financial Statements. The guide supported historical cost as the primary basis of measurement for personal financial statements. However, the increasing use of personal financial statements in practice resulted in a need to reassess that conclusion.

In recognition of the intended use of personal financial statements, the AICPA issued Statement of Position 82-1, Accounting and Reporting for Personal Financial Statements, on October 1, 1982. Effective for statements dated June 30, 1983 and after, the SOP superseded the existing guide.

Consequently, the AICPA issued a new guide in 1983 based on the SOP entitled, Personal Financial Statements Guide. The new guide and the SOP offers guidance on personal financial statements that use the estimated current values of assets and the estimated current amounts of liabilities as the basis for presentation.

In addition, the SOP provides guidelines for determining the current values and disclosure requirements. The new guide offers illustrative financial statements and reports and considerations to be made at various levels of professional service.

Basic Financial Statements

Personal financial statements consist of a statement of financial condition. This is the basic personal financial statement. It presents the estimated current values of assets, the estimated current amounts of liabilities, the estimated income taxes on the difference between the estimated current value of assets and the estimated current amounts of liabilities and their tax bases, and the net worth of the individual(s) at a specified date.

A statement of changes in net worth presents the major sources of increases and decreases in net worth. It presents the major sources of increases in net worth: income, increases in the estimated current values of assets, decreases in the estimated current amounts of liabilities, and decreases in the estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases. It presents the major sources of decreases in net worth: expenses, decreases in the current estimated values of assets, increases in the estimated current amounts of liabilities, and increases in the estimated income taxes on the difference between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases. One statement that combines income and other changes is desirable because of the mix of business and personal items in personal financial statements. The statement of changes in net worth is optional.

Usually, the presentation of comparative financial statements (that is, presentation of the current period and one or more prior periods) is desirable because it is more informative, but it is not required.

General Comments on the Use of a Checklist

Although authoritative literature does not require the use of a checklist, many auditors and accountants find it helpful to use as a practice aid in accounting and reporting. The format and content of a checklist often varies. Some accounting firms have developed their own checklists for internal use, and may have developed specialized checklists to meet the needs of their practices (such as checklists for clients in a particular industry or for clients that report to the SEC). Some state CPA societies have developed checklists for their membership that may be available to other practitioners as well. Various commercial publishers include checklists in some of their publications.

The following is a list of references made:

- GUD-PFS = AICPA Personal Financial Statements Guide (1983)
- SOP 82-1 = AICPA Statement of Position 82-1, (October 1, 1982),
effective for statements dated June 30, 1983 and after

I. ACCOUNTING

A. The Methods of Presentation	<u>YES</u>	<u>NO</u>	<u>N/A</u>
1. Are assets and liabilities and changes in them recognized on the accrual basis? [SOP 82-1, par. 7]	_____	_____	_____
a. If not, are they on an other comprehensive basis of accounting?	_____	_____	_____
2. Are assets and liabilities presented in order of liquidity and maturity (in an unclassified manner)? [SOP 82-1, par. 8]	_____	_____	_____
3. If the statements are prepared for one of a group of joint owners, do they include only the person's interest as a beneficial owner (as determined under the property laws of the state having jurisdiction)?	_____	_____	_____
a. If property is held in joint tenancy, as community property, or through a similar joint ownership arrangement and it is determined that the person's interest should be included among his assets, is there a proper allocation of the equity under the applicable state laws? [SOP 82-1, par. 9]	_____	_____	_____
4. Are business interests that constitute a large part of a person's total assets shown separately from other investments?	_____	_____	_____
a. Is the estimated current value of an investment in a separate entity shown in one amount if the entity is marketable as a going concern?	_____	_____	_____
b. Are assets and liabilities of the separate entity not combined with similar personal items? [SOP 82-1, par. 10]	_____	_____	_____

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
5. Are the estimated current values of assets and the estimated current amounts of liabilities of limited business activities not conducted as a separate business entity presented as separate amounts? [SOP 82-1 par. 11]	---	---	---
B. Guidelines for Determining the Estimated Current Values of Assets and the Estimated Current Amounts of Liabilities			
1. General			
a. Are costs of disposal considered in determining estimated current values?	---	---	---
b. Has judgment been exercised in determining estimated current values? [SOP 82-1, par. 12]	---	---	---
c. Are the methods used to determine current estimated values of assets and current estimated amounts of liabilities followed consistently from period to period (unless facts and circumstances dictate a change)? [SOP 82-1, par. 15]	---	---	---
2. Receivables			
a. Are receivables presented at the discounted amounts of cash the person estimates will be collected (using appropriate interest rates at the financial statement date)? [SOP 82-1, par. 16]	---	---	---
3. Marketable Securities			
a. Do marketable securities include both debt and equity securities for which market quotations are available?	---	---	---

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
(1). Are the estimated current values of such securities their quoted market prices?	_____	_____	_____
(2). Are the estimated current values of securities traded on securities exchanges the closing prices on the financial statement date (valuation date) if they were traded on that date?	_____	_____	_____
(a). If the securities were not traded on that date, but published bid and asked prices were available, are the estimated current values within the range of those prices? [SOP 82-1, par. 17]	_____	_____	_____
b. For securities traded in the over-the-counter market, are the estimated current values (a) the mean of the bid prices, (b) the mean of the bid and asked prices or (c) the mean of the prices of a representative selection of broker-dealers quoting the securities? [SOP 82-1, par. 18]	_____	_____	_____
c. In determining the estimated current value and assessing the recent market price, was consideration made of:			
(1). A large block of stock perhaps not being salable at the price a small number of shares would?	_____	_____	_____
(2). A large minority interest being difficult to sell?	_____	_____	_____
(3). A controlling interest being proportionately more valuable than a minority interest?	_____	_____	_____
(4). Restrictions on the transfer of securities? [SOP 82-1, par. 19]	_____	_____	_____

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
4. Options			
a. If published prices are unavailable, are estimated current values determined on the basis of the values of the assets subject to option?	___	___	___
b. Was consideration made of the exercise prices and length of the option periods? [SOP 82-1, par. 20]	___	___	___
5. Investment in Life Insurance			
a. Is the estimated current value of an investment in life insurance the cash value of the policy less the amount of any loans against it?	___	___	___
6. Investments in Closely Held Businesses			
a. Is only the net investment in the enterprise presented?			
(1). Is the net investment presented at its estimated current value at the financial statement date?	___	___	___
b. Has judgment been exercised in determining the value? [SOP 82-1, par. 22]	___	___	___
7. Real Estate (Including Leaseholds)			
a. Are investments in real estate (including leaseholds) presented at their estimated current values? [SOP 82-1, par. 24]	___	___	___
8. Intangible Assets			
a. Are intangible assets presented at the discounted amounts of projected cash receipts and payments arising from the planned use or sale of the assets (if both the amounts and timing can reasonably be estimated)?	___	___	___
b. If no other information is available, is the cost of a purchased			

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
intangible asset used? [SOP 82-1, par. 25]	—	—	—
9. Future Interests and Similar Assets			
a. Are all nonforfeitable rights to receive future sums that (a) are fixed or determinable in amount, (b) are not contingent on the holder's life or the occurrence of a particular event, and (c) do not require future performance presented as assets at their discounted amounts? [SOP 82-1, par. 26]	—	—	—
10. Payables and Other Liabilities			
a. Are payables and other liabilities presented at the discounted amounts of cash to be paid?	—	—	—
(1). Is the discount rate the rate implicit in the transaction in which the debt was incurred?	—	—	—
b. If the debtor is able to discharge the debt currently at a lower amount, is the debt presented at the lower amount? [SOP 82-1, par. 27]	—	—	—
11. Noncancellable Commitments			
a. Are all noncancellable commitments to pay future sums that (a) are fixed or determinable in amount, (b) are not contingent on another's life or the occurrence of a particular event, and (c) do not require future performance, presented as liabilities at their discounted amounts? [SOP 82-1, par. 28]	—	—	—
12. Income Taxes Payable			
a. Does the liability for income taxes payable include unpaid income taxes for completed tax years and an estimated amount for taxes accrued			

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
for the elapsed portion of the current tax year to the financial statement date?	_____	_____	_____
b. Is the estimate based on the relationship of taxable income earned to date to total estimated taxable income for the year (net of taxes withheld or paid with estimated income tax returns)? [SOP 82-1, par. 29]	_____	_____	_____
13. Estimated Income Taxes on the Differences Between the Estimated Current Values of Assets and the Estimated Current Amounts of Liabilities and Their Tax Bases			
a. Is a provision made for estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases?	_____	_____	_____
(1). Was consideration given to the negative tax bases of tax shelters, if any?	_____	_____	_____
(2). Was the provision computed as if the estimated current values of all assets had been realized and the estimated current amounts of all liabilities had been liquidated on the statement date?	_____	_____	_____
(3). Were applicable income tax laws and regulations used?	_____	_____	_____
(4). Was consideration given to recapture provisions and available carryovers?	_____	_____	_____
b. Are the estimated income taxes presented between liabilities and net worth in the statement of financial condition? [SOP 82-1, par. 30]	_____	_____	_____

YES NO N/A

II. FINANCIAL STATEMENT DISCLOSURES

- A. Is (Are) the individual(s) covered by the financial statements clearly indicated? _____
- B. Is the fact that assets are presented at their estimated current values and liabilities at their estimated current amounts disclosed? _____
- C. Are the methods used in determining the estimated current values of major assets and the estimated current amounts of major liabilities disclosed? _____
1. Are changes in the methods from one period to the next disclosed, if any? _____
- D. If assets included in the financial statements are held jointly by the person and by others, is the nature of the joint ownership disclosed? _____
- E. If the person's investment portfolio is material in relation to his other assets and is concentrated in one or a few companies or industries, are the names of the companies or industries disclosed? _____
1. Are the estimated current values of the securities disclosed? _____
- F. If the person has a material investment in a closely held business, did he disclose:
1. The name of the company? _____
2. The percentage of ownership? _____
3. The nature of the business? _____
4. Summarized financial information about assets, liabilities, and results of operations for the most recent year based on the financial statements of the business (including information about the basis of presentation)? _____

	<u>YES</u>	<u>NO</u>	<u>N/A</u>
G. Are descriptions of intangible assets made?	___	___	___
1. Are their estimated useful lives disclosed?	___	___	___
H. Is the face amount of life insurance owned by the individual(s) disclosed?	___	___	___
I. Are nonforfeitable rights (not having the characteristics of future interests or similar assets) disclosed?	___	___	___
J. Tax Information			
1. Are the methods and assumptions used to compute the estimated income taxes on the difference between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases disclosed?	___	___	___
2. Do the disclosures include a statement that the provision will probably differ from the amounts of income taxes that might eventually be paid because those amounts are determined by the timing and the method of disposal, realization, or liquidation and the tax laws and regulations in effect at the time?	___	___	___
3. Are unused operating loss and capital loss carryforwards disclosed?	___	___	___
4. Are other unused deductions and credits disclosed including their expiration dates, if applicable?	___	___	___
5. Are the differences between the estimated current values of major assets and the estimated current amounts of major liabilities and their tax bases disclosed?	___	___	___
K. Are maturities, interest rates, collateral, and other pertinent details relating to receivables and debt disclosed?	___	___	___

YES NO N/A

- L. Are noncancellable commitments (failing to have the characteristics of being fixed, not contingent, and not requiring future performance) disclosed?
[SOP 82-1, par. 31]

Editor's note--Generally accepted accounting principles other than the above may apply to personal financial statements. For example, SFAS No. 5, Accounting for Contingencies, and its related amendments and interpretations and SFAS No. 57, Related Party Disclosures, provide guidance on reporting contingencies and related-party transactions, respectively.

ILLUSTRATIVE REPORTS

Compilation Report

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] 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 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.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.17]

Compilation Report—Statement of Financial Condition Only

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], 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 the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying statement of financial condition, and, accordingly, do not express an opinion or any other form of assurance on it.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.17]

Compilation Report—Omission of Substantially All Disclosures

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] 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 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.

James and Jane Person have elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the financial condition of James and Jane Person and changes in their net worth. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.21]

Compilation Report—GAAP Departure—Material Assets at Cost

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] 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 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. However, I (we) did become aware of a departure from generally accepted accounting principles that is described in the following paragraph.

*Note: When personal financial statements omit substantially all disclosures and do not disclose that the assets are presented at their estimated current values and that the liabilities are presented at their estimated current amounts, the accountant should include the following sentence at the end of the first paragraph of his report:

The financial statements are intended to present the assets of James and Jane Person at estimated current value and their liabilities at estimated current amounts.

As disclosed in Note X to the financial statements, generally accepted accounting principles require that assets be presented at their estimated current values and that liabilities be presented at their estimated current amounts. James and Jane Person have informed me (us) that their investment in ABC Company is stated in the accompanying financial statements at cost and that the effects of this departure from generally accepted accounting principles on their financial condition and the changes in their net worth have not been determined.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.40]

Compilation Report—Income Tax Basis

I (we) have compiled the accompanying statement of assets and liabilities—income tax basis of James and Jane Person as of *[date]*, and the related statement of changes in net assets—income tax basis for the *[period]* 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 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.

[Source: AICPA *Professional Standards*, vol. 2, sec. 9100.45]

Compilation Report—Financial Statements Included in a Prescribed Form

I (we) have compiled the *[identification of financial statements, including period covered and name of individual(s)]* included in the accompanying prescribed form, in accordance with standards established by the American Institute of Certified Public Accountants.

My (our) compilation was limited to presenting in the form prescribed by *[name of body]* information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements (including related disclosures) are presented in accordance with the requirements of *[name of body]*, which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

[Source: AICPA *Professional Standards*, vol. 2, sec. 300.03]

Review Report

I (we) have reviewed the accompanying statement of financial condition of James and Jane Person as of *[date]*, and the related statement of changes in net worth for the *[period]* 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 James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented 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 generally accepted accounting principles.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.35]

Review Report—Statement of Financial Condition Only

I (we) have reviewed the accompanying statement of financial condition of James and Jane Person as of *[date]*, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in this financial statement is the representation of James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented 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 statement of financial condition in order for it to be in conformity with generally accepted accounting principles.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.35]

Review Report—GAAP Departure—Failure to Include a Provision for Estimated Income Taxes on the Differences Between the Estimated Current Values of Assets and the Estimated Current Amounts of Liabilities and Their Tax Bases

I (we) have reviewed the accompanying statement of financial condition of James Person as of [date], and the related statement of changes in net worth for the [period] 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 James Person.

A review of personal financial statements consists principally of inquiries of the individual whose financial statements are presented 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, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Generally accepted accounting principles require that personal financial statements include a provision for estimated income taxes on the differences between the estimated current values of assets and estimated current amounts of liabilities and their tax bases. The accompanying financial statements do not include such a provision and the effect of this departure from generally accepted accounting principles has not been determined.

[Source: AICPA *Professional Standards*, vol. 2, sec. 100.40]

Review Report—Income Tax Basis

I (we) have reviewed the accompanying statement of assets and liabilities—income tax basis of James and Jane Person as of [date], and the related statement of changes in net assets—income tax basis for the [period] 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 James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented 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 historical cost basis of accounting described in Note X.

[Source: AICPA *Professional Standards*, vol. 2, sec. 9100.45]

Auditor's Report

Independent Auditor's Report

[Addressee]

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (We) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (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 James and Jane Person, as well as evaluating the overall financial statement presentation. I (We) believe that my (our) audit provides a reasonable basis for my (our) opinion.

In my (our) opinion, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, par. 8]

Auditor's Report—Statement of Financial Condition Only

Independent Auditor's Report

[Addressee]

I (We) have audited the statement of financial condition of James and Jane Person as of [date]. The financial statement is the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on the financial statement based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (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 James and Jane Person, as well as evaluating the overall financial statement presentation. I (We) believe that my (our) audit provides a reasonable basis for my (our) opinion.

In my (our) opinion, the financial statement referred to above presents fairly, in all material respects, the financial condition of James and Jane Person as of [date] in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, par. 48]

Auditor's Report—Departure from GAAP—Inappropriate Valuation Methods—Qualified Opinion

Independent Auditor's Report

[Addressee]

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (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 James and Jane Person, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

As discussed in Note X to the financial statements, assets amounting to \$XX,XXX (XX percent of total assets) as of [date] have been valued at estimated current value as determined by James Person. I (we) have reviewed the procedures applied by James Person in valuing the assets and have inspected the underlying documentation. In my (our) opinion, those procedures are not appropriate to determine the estimated current values of the assets in conformity with generally accepted accounting principles. The effects on the financial statements of not applying appropriate procedures to determine the estimated current values of the assets are not reasonably determinable.

In my (our) opinion, except for the effects on the financial statements of the valuation of assets determined by James Person, as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, par. 53]

Auditor's Report—Departure from GAAP—Inappropriate Valuation Methods—Adverse Opinion

Independent Auditor's Report

[Addressee]

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (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 James and Jane Person, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

As discussed in Note X to the financial statements, assets amounting to \$XX,XXX (XX percent of total assets) as of [date] have been valued at estimated current value as determined by James Person. I (we) have reviewed the procedures applied by James Person in valuing the assets and have inspected the underlying documentation. In my (our) opinion, those procedures are not appropriate to determine the estimated current values of the assets in conformity with generally accepted accounting principles. It is not practicable to disclose the principal effects on the financial statements of not applying appropriate procedures to determine the estimated current values of the assets.

In my (our) opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended.

[Signature]

[Date]

[Source: SAS No. 58, par. 69]

Auditor's Report—Scope Limitation—Inadequate Records

Independent Auditor's Report

[Addressee]

I (We) have audited the statement of financial condition of James and Jane Person as of *[date]*, and the related statement of changes in net worth for the *[period]* then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

Except as discussed in the following paragraph, I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (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 James and Jane Person, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

James and Jane Person do not maintain accounting records sufficient to assure that all transactions are recorded. Accordingly, it was not practicable for me (us) to extend my (our) auditing procedures sufficiently to determine that all of their assets and liabilities and the changes in their net worth are recorded in the financial statements referred to above.

In my (our) opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I (we) been able to determine that all assets and liabilities and changes in net worth were recorded in the financial statements, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of *[date]*, and the changes in their net worth for the *[period]* then ended, in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, par. 44]

Auditor's Report—Inadequate Records Preclude Opinion

Independent Auditor's Report

[Addressee]

I was (We were) engaged to audit the statement of financial condition of James and Jane Person as of *[date]*, and the related statement of changes in net worth for the *[period]* then ended. These financial statements are the responsibility of James and Jane Person.

James and Jane Person do not maintain accounting records sufficient to assure that all transactions are recorded. Accordingly, it was not practicable for me (us) to extend my (our) auditing procedures sufficiently to determine that all of their assets and liabilities and the changes in their net worth are recorded in the financial statements referred to above.

Because James and Jane Person do not maintain certain accounting records and supporting documentation, and because I was (we were) unable to apply adequate auditing procedures regarding the recording of transactions as noted in the preceding paragraph, the scope of my (our) work was not sufficient to enable me (us) to express, and I (we) do not express, an opinion on the financial statements referred to above.

[Signature]

[Date]

[Source: SAS No. 58, par. 72]

Auditor's Report—Income Tax Basis Statements

Independent Auditor's Report

[Addressee]

We have audited the accompanying statement of assets and liabilities—income tax basis of James and Jane Person as of [date], and the related statement of receipts and disbursements—income tax basis for the [period] then ended. These financial statements are the responsibility of James and Jane Person. Our responsibility is to express an opinion on these financial statements 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 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 James and Jane Person, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

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

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

ILLUSTRATIVE FINANCIAL STATEMENTS

James and Jane Person Statements of Financial Condition December 31, 19X3 and 19X2

	December 31,	
	19X3	19X2
Assets		
Cash	\$ 3,700	\$ 15,600
Bonus receivable	20,000	10,000
Investments		
Marketable securities (Note 2)	160,500	140,700
Stock options (Note 3)	28,000	24,000
Kenbruce Associates (Note 4)	48,000	42,000
Davekar Company, Inc. (Note 5)	550,000	475,000
Vested interest in deferred profit sharing plan	111,400	98,900
Remainder interest in testamentary trust (Note 6)	171,900	128,800
Cash value of life insurance (\$43,600 and \$42,900), less loans payable to insurance companies (\$38,100 and \$37,700) (Note 7)	5,500	5,200
Residence (Note 8)	190,000	180,000
Personal effects (excluding jewelry) (Note 9)	55,000	50,000
Jewelry (Note 9)	40,000	36,500
	<u>\$1,384,000</u>	<u>\$1,206,700</u>
 Liabilities		
Income taxes—current year balance	\$ 8,800	\$ 400
Demand 10.5% note payable to bank	25,000	26,000
Mortgage payable (Note 10)	98,200	99,000
Contingent liabilities (Note 11)		
	132,000	125,400
Estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases (Note 12)	239,000	160,000
Net worth	<u>1,013,000</u>	<u>921,300</u>
	<u>\$1,384,000</u>	<u>\$1,206,700</u>

The notes to financial statements are an integral part of these statements.

James and Jane Person
Statements of Changes in Net Worth
For the Years Ended December 31, 19X3 and 19X2

	Year ended December 31,	
	19X3	19X2
Realized increases in net worth		
Salary and bonus	\$ 95,000	\$ 85,000
Dividends and interest income	2,300	1,800
Distribution from limited partnership	5,000	4,000
Gains on sales of marketable securities	1,000	500
	103,300	91,300
Realized decreases in net worth		
Income taxes	26,000	22,000
Interest expense	13,000	14,000
Real estate taxes	4,000	3,000
Personal expenditures	36,700	32,500
	79,700	71,500
Net realized increase in net worth	23,600	19,800
Unrealized increases in net worth		
Marketable securities (net of realized gains on securities sold)	3,000	500
Stock options	4,000	500
Davekar Company, Inc.	75,000	25,000
Kenbruce Associates	6,000	
Deferred profit sharing plan	12,500	9,500
Remainder interest in testamentary trust	43,100	25,000
Jewelry	3,500	
	147,100	60,500
Unrealized decrease in net worth		
Estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases	79,000	22,000
Net unrealized increase in net worth	68,100	38,500
Net increase in net worth	91,700	58,300
Net worth at the beginning of year	921,300	863,000
Net worth at the end of year	\$1,013,000	\$ 921,300

The notes to financial statements are an integral part of these statements.

**James and Jane Person
Notes to Financial Statements**

Note 1. The accompanying financial statements include the assets and liabilities of James and Jane Person. Assets are stated at their estimated current values, and liabilities at their estimated current amounts.

Note 2. The estimated current values of marketable securities are either (a) their quoted closing prices or (b) for securities not traded on the financial statement date, amounts that fall within the range of quoted bid and asked prices.

Marketable securities consist of the following:

	December 31, 19X3		December 31, 19X2	
	Number of shares or bonds	Estimated current values	Number of shares or bonds	Estimated current values
Stocks				
Jaiven Jewels, Inc.	1,500	\$ 98,813		
McRae Motors, Ltd.	800	11,000	600	\$ 4,750
Parker Sisters, Inc.	400	13,875	200	5,200
Rosenfield Rug Co.			1,200	96,000
Rubin Paint Company	300	9,750	100	2,875
Weiss Potato Chips, Inc.	200	20,337	300	25,075
		153,775		133,900
Bonds				
Jackson Van Lines, Ltd. (12% due 7/1/X9)	5	5,225	5	5,100
United Garvey, Inc. (7% due 11/15/X6)	2	1,500	2	1,700
		6,725		6,800
		\$160,500		\$140,700

Note 3. Jane Person owns options to acquire 4,000 shares of stock of Winner Corp. at an option price of \$5 per share. The option expires on June 30, 19X5. The estimated current value is its published selling price.

Note 4. The investment in Kenbruce Associates is an 8% interest in a real estate limited partnership. The estimated current value is determined by the projected annual cash receipts and payments capitalized at a 12% rate.

Note 5. James Person owns 50% of the common stock of Davekar Company, Inc., a retail mail order business. The estimated current value of the investment is determined by the provisions of a shareholders' agreement, which restricts the sale of the stock and, under certain conditions, requires the company to repurchase the stock based on a price equal to the book value of the net assets plus an agreed amount for goodwill. At December 31, 19X3, the agreed amount for goodwill was \$112,500, and at December 31, 19X2, it was \$100,000.

A condensed balance sheet of Davekar Company, Inc., prepared in conformity with generally accepted accounting principles, is summarized below:

	December 31,	
	19X3	19X2
Current assets	\$3,147,000	\$2,975,000
Plant, property, and equipment—net	165,000	145,000
Other assets	120,000	110,000
Total assets	3,432,000	3,230,000
Current liabilities	2,157,000	2,030,000
Long-term liabilities	400,000	450,000
Total liabilities	2,557,000	2,480,000
Equity	\$ 875,000	\$ 750,000

The sales and net income for 19X3 were \$10,500,000 and \$125,000 and for 19X2 were \$9,700,000 and \$80,000.

Note 6. Jane Person is the beneficiary of a remainder interest in a testamentary trust under the will of the late Joseph Jones. The amount included in the accompanying statements is her remainder interest in the estimated current value of the trust assets, discounted at 10%.

Note 7. At December 31, 19X3 and 19X2, James Person owned a \$300,000 whole life insurance policy.

Note 8. The estimated current value of the residence is its purchase price plus the cost of improvements. The residence was purchased in December 19X1, and improvements were made in 19X2 and 19X3.

Note 9. The estimated current values of personal effects and jewelry are the appraised values of those assets, determined by an independent appraiser for insurance purposes.

Note 10. The mortgage (collateralized by the residence) is payable in monthly installments of \$815 a month, including interest at 10% a year through 20Y8.

Note 11. James Person has guaranteed the payment of loans of Davekar Company, Inc., under a \$500,000 line of credit. The loan balance was \$300,000 at December 31, 19X3, and \$400,000 at December 31, 19X2.

Note 12. The estimated current amounts of liabilities at December 31, 19X3, and December 31, 19X2, equaled their tax bases. Estimated income taxes have been provided on the excess of the estimated current values of assets over their tax bases as if the estimated current values of the assets had been realized on the statement date, using applicable tax laws and regulations. The provision will probably differ from the amounts of income taxes that eventually might be paid because those amounts are determined by the timing and the method of disposal or realization and the tax laws and regulations in effect at the time of disposal or realization.

The estimated current values of assets exceeded their tax bases by \$850,000 at December 31, 19X3, and by \$770,300 at December 31, 19X2. The excess of estimated current values of major assets over their tax bases are—

	December 31,	
	19X3	19X2
Investment in Davekar Company, Inc.	\$430,500	\$355,500
Vested interest in deferred profit sharing plan	111,400	98,900
Investment in marketable securities	104,100	100,000
Remainder interest in testamentary trust	97,000	53,900

Computing the Excess of the Estimated Current Values of Assets Over Their Tax Bases and the Estimated Income Taxes on the Excess

This section relates to the preceding illustrative financial statements of James and Jane Person and illustrates how to compute the excess of the estimated current values of assets over their tax bases and the provision for estimated income taxes on the excess.¹

The excess or deficit of the estimated current values of major assets or categories of assets over their tax bases should be disclosed.² The provision for estimated income taxes should be presented in the statement of financial condition between liabilities and net worth.

The assumptions and the tax basis information used in computing the excess of the estimated current values of assets over their tax bases and the estimated income taxes on the excess depend on the facts, circumstances, tax laws and regulations, and assumptions that apply to the individual or individuals for whom the financial statements are prepared. The facts, circumstances, tax laws and regulations, and assumptions used in the following are illustrative only.

Description	(A) Estimated current values	(B) Tax bases	Excess of (A) over (B)	Effective income tax rates	Amount of estimated income taxes	Assumptions used
Cash	\$ 3,700	\$ 3,700	—	—	—	No tax effect.
Bonus receivable	20,000	—	\$ 20,000	50%	\$ 10,000	Maximum tax rate.
Investments						
Marketable securities	160,500	56,400	104,100	36%	37,500	Weighted average of short-term and long-term capital gain rates based on composition of portfolio.
Stock options	28,000	20,000	8,000	50%	4,000	Short-term capital gain rate.
Kenbruce Associates	48,000	24,000	24,000	38%	9,100	Weighted average of short-term and long-term capital gain rates.
Davekar Company, Inc.	550,000	119,500	430,500	20%	86,100	Long-term capital gain rate.
Vested interest in deferred profit sharing plan	111,400	—	111,400	50%	55,700	Maximum tax rate.
Remainder interest in testamentary trust	171,900	74,900	97,000	26%	25,600	Weighted average of short-term and long-term capital gain rates.
Cash value of life insurance	5,500	5,500	—	—	—	No tax effect.
Residence	190,000	190,000	—	—	—	No tax effect.
Personal effects	55,000	30,000	25,000	20%	5,000	Long-term capital gain rate.
Jewelry	40,000	10,000	30,000	20%	6,000	Long-term capital gain rate.
	<u>\$1,384,000</u>	<u>\$534,000</u>	<u>\$850,000³</u>		<u>\$239,000⁴</u>	

¹ The provision for estimated income taxes should also reflect tax consequences that result from differences between the estimated current amounts of liabilities and their tax bases.

² Differences between the estimated current amounts of major liabilities or categories of liabilities and their tax bases should also be disclosed.

³ The excess or deficit of the estimated current values of major assets or categories of assets over their tax bases should be disclosed.

⁴ This amount should be presented in the statement of financial condition between liabilities and net worth.

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