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Compilation and review engagements, March 1, 2011; Audit and Accounting Guide

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

G U I D E

Compilation and Review Engagements

March 1, 2011

AICPA

Guide: Compilation and Review Engagements

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G U I D E

Compilation and Review Engagements

March 1, 2011

This edition of the AICPA Guide *Compilation and Review Engagements*, which was originally issued in 2010, has been modified by the AICPA staff to include certain changes necessary because of the issuance of authoritative pronouncements since the guide was originally issued and other changes necessary to keep the guide current on industry and regulatory matters. The schedule of changes appendix identifies all changes made in this edition of the guide. The changes do *not* include all those that might be considered necessary if the guide was subjected to a comprehensive review and revision.

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Preface

This AICPA Guide has been developed under the supervision of the Accounting and Review Services Committee (ARSC). The purpose of this guide is to assist accountants in compiling or reviewing financial statements in accordance with the Statements on Standards for Accounting and Review Services (SSARSs) issued by the AICPA. An accountant must perform a compilation or review of a nonissuer in accordance with SSARSs.[1] *Nonissuers* are entities other than issuers, as defined by the Sarbanes-Oxley Act of 2002, or other entities that are required to be audited by a registered accounting firm, as prescribed by the rules of the Securities and Exchange Commission.

Compilation and review guidance included in this guide is an interpretive publication, pursuant to paragraph .18 of AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements* (AICPA, *Professional Standards*). This interpretive publication includes recommendations on the application of SSARSs in specific circumstances. This interpretive publication is issued under the authority of ARSC after all members have been provided an opportunity to consider and comment on whether the proposed interpretive publication is consistent with SSARSs. The members of ARSC have found this guide to be consistent with the existing SSARSs.

An accountant should be aware of and consider interpretive publications applicable to his or her compilation or review. If the accountant does not apply the guidance included in this guide, the accountant should be prepared to explain how he or she complied with the SSARSs' provisions addressed by such guidance.

A glossary of terms, several appendixes, and an exhibit have been included in this guide to provide the reader with additional sources of information related to compilation and review engagements. The additional material includes

- appendix A, "Understanding Internal Control and Internal Control Services," which discusses the concept of internal control and what constitutes *internal control services*;
- appendix B, "Compilation Reporting Requirements When Independence Is Impaired," which discusses the accountant's reporting requirements in a compilation engagement when an accountant's independence is impaired;
- appendix C, "Reporting on Compiled or Reviewed Financial Statements for Periods Ended on or After December 15, 2010, With Comparative Financial Statements for Periods Ended Before December 15, 2010," which discusses the accountant's reporting requirements on comparative financial statements when the prior year compilation or review was not performed in accordance with

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[1] Paragraph .01 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), scopes out certain reviews of interim financial information. In February 2011, the Accounting and Review Services Committee issued Statement on Standards for Accounting and Review Services (SSARS) No. 20, *Revised Applicability of Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*, AR sec. 90 par. .01). SSARS No. 20 is effective for reviews of financial statements for periods beginning after December 15, 2011, with early application permitted. SSARS No. 20 revises the condition in item (*b*)(ii) of paragraph .01 of AR section 90. Footnote * in paragraph 4.05 of this guide provides additional discussion regarding the effect on paragraph .01 of AR section 90 due to the issuance of SSARS No. 20.

SSARS No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*); and

- the exhibit "Compilations and Reviews of Personal Financial Statements" which discusses the applicability of SSARSs when accountants are engaged to compile or review personal financial statements.

Lastly, this guide also includes an index to assist readers in locating discussion of a specific topic within the guide.

Recognition

Carolyn H. McNerney
Chair, Accounting and Review Services Committee

The AICPA gratefully appreciates the invaluable assistance Thomas A. Ratcliffe provided in developing and writing the guidance in this guide.

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Guidance Considered in This Edition

Relevant guidance issued through March 1, 2011, has been considered in this guide. This includes relevant guidance issued up to and including the following:

- SSARS No. 20, *Revised Applicability of Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*, AR sec. 90 par. .01)
- Interpretation No. 16, "Preparation of Financial Statements for Use by an Entity's Auditors," of AR section 80, *Compilation of Financial Statements* (AICPA, *Professional Standards*, AR sec. 9080 par. .61–.62)
- Revised interpretations issued through March 1, 2011, including all interpretations to AR section 80 and AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), which were conformed to SSARS No. 19

Users of this guide should consider guidance issued subsequent to those previously listed to determine the effect of such guidance on their compilation and review engagements. In determining the applicability of recently issued guidance, its effective date should be considered.

The changes made to this edition of the guide are identified in the schedule of changes appendix. The changes do not include all those that might be considered necessary if the guide were subjected to a comprehensive review and revision.

References to Professional Standards

In citing the compilation and review standards and their related interpretations, references use section numbers within the codification of currently effective SSARSs and not the original statement number, as appropriate. For example, SSARS No. 20 is referred to as paragraph .01 of AR section 90.

New AICPA.org Website

The AICPA encourages you to visit its new website at www.aicpa.org. It was launched in 2010 and provides significantly enhanced functionality and content critical to the success of AICPA members and other constituents. Certain content on the AICPA's website referenced in this guide may be restricted to AICPA members only.

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Appendix

A Understanding Internal Control and Internal Control Services

B Compilation Reporting Requirements When Independence Is Impaired

C Reporting on Compiled or Reviewed Financial Statements for Periods Ended On or After December 15, 2010, With Comparative Financial Statements for Periods Ended Before December 15, 2010

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Chapter 1

Framework and Objectives for Performing and Reporting on Compilation and Review Engagements

Introduction

1.01 It is important for the accountant to understand the framework upon which the performance and reporting requirements in the Statements on Standards for Accounting and Review Services (SSARSs) are based. With this understanding, the accountant will be better able to perform compilation and review engagements and report on the compiled or reviewed financial statements. The framework for compilation and review engagements is included in AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements* (AICPA, *Professional Standards*).

1.02 The framework includes a discussion of the elements of compilation and review engagements. Although each of the five elements is discussed later in this chapter, as stated in paragraph .26 of AR section 60, they are as follows:

- A three party relationship involving management, an accountant, and intended users
- An applicable financial reporting framework
- Financial statements or financial information
- In a review, sufficient appropriate review evidence
- A written communication or report

1.03 The framework also includes a discussion of materiality. The discussion is particularly helpful when the accountant is performing a review engagement. In a review engagement, the accountant expresses in the review report that the accountant is "not aware of any material modifications that should be made to the financial statements." Although the materiality guidance is written more from a review perspective, the concept also is applicable to compilation engagements.

1.04 Throughout SSARSs, accountants will notice a reference to applicable financial reporting frameworks. Using this terminology just makes the literature easier to read. Accountants may compile or review financial statements prepared in accordance with several different frameworks for various clients. Further examples are given in the "Definitions" section that follows.

1.05 A review engagement is an assurance engagement. As such, and consistent with paragraph .44 of AR section 60, the accountant should apply professional judgment in determining the specific nature, timing, and extent of review procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

Definitions

1.06 AR section 60 includes definitions to help the accountant understand compilation and review performance and reporting requirements. Some of the key issues that accountants need to understand related to the definitions are discussed in this section, as well as in the glossary in this guide.

Applicable Financial Reporting Framework

1.07 A *financial reporting framework*, in general, is a set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements. Various financial reporting frameworks might be used by management and, when applicable, those charged with governance in preparing financial statements. For example, the accountant might perform engagements related to statements that are prepared in accordance with accounting principles generally accepted in the United States of America (generally referred to as U.S. GAAP); International Financial Reporting Standards (IFRSs), as issued by the International Accounting Standards Board (IASB); or an other comprehensive basis of accounting (OCBOA) such as the cash basis or income tax basis of accounting, among other frameworks. The applicable financial reporting framework is the one used in preparing the financial statements.

Observations and Suggestions

The applicable financial reporting framework used to prepare the financial statements is a management decision and, when applicable, a decision involving those charged with governance of the reporting entity. That decision is made based on the nature of the entity and the objective of the financial statements, and sometimes, the appropriate framework is required by law or regulation.

The performance requirements with respect to the review or compilation engagement are the same, regardless of the framework used to prepare the financial statements. With that stated, the compilation and review reports refer to the basis of accounting used to prepare the financial statements.

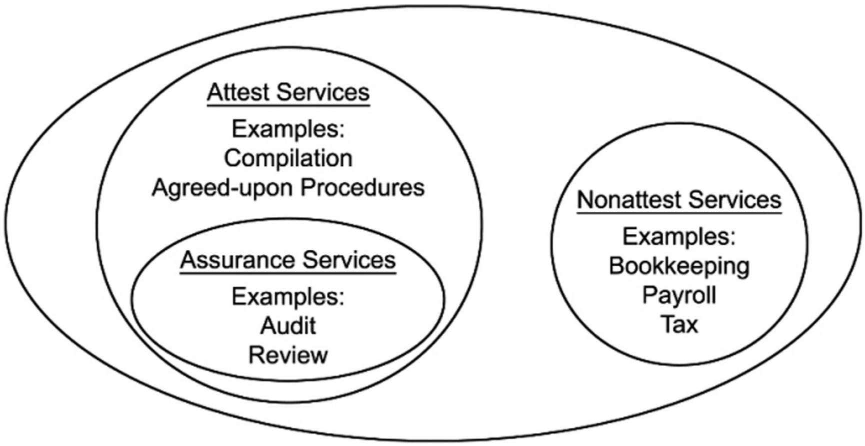
Assurance Engagement

1.08 An *assurance engagement* is one in which an accountant issues a report designed to enhance the degree of confidence of users of financial statements about the outcome of an evaluation or measurement of financial statements against an applicable financial reporting framework. A review engagement is an assurance engagement in that the accountant designs procedures to obtain a limited level of assurance through performing review procedures that allows the accountant to issue the review report. A compilation is not performed with the objective of obtaining any assurance related to the financial statements and, as such, is not an assurance engagement.

Observations and Suggestions

Illustration 1-1

Universe of CPA Services



Nonissuer

1.09 Because SSARSs are only applicable for compilation and review engagements of nonissuers, it is important to understand whether the reporting entity is a nonissuer. A *nonissuer* would be considered all entities except for those defined in Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), the securities of which are registered under Section 12 of that act (15 U.S.C. 78l), or that is required to file reports under Section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a, et seq.), and that it has not withdrawn.

Management and Those Charged With Governance

1.10 In distinguishing between management and those charged with governance, *management* would be those with executive responsibility for the conduct of the entity's operations. Management is responsible for

- the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- preventing and detecting fraud.
- identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

On the other hand, those charged with governance have the responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance are specifically excluded from management, unless they perform management functions. However, for some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Observations and Suggestions

As previously stated, management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework. The accountant may, however, make suggestions about the form or content of the financial statements or draft them, in whole or in part, based on information obtained from management during the performance of the compilation or review. However, the accountant's responsibility for the financial statements he or she has compiled or reviewed is confined to the accountant's compilation or review report on those financial statements.

Third Party

1.11 For purposes of implementing SSARSs, third parties constitute all persons except for members of management. Importantly, unless they also are involved in management of the reporting entity, those charged with governance would constitute third parties. So, for example, it would be inappropriate to use the nonreporting option compilation in which financial statements are restricted for management use only if the financial statements will be used by those charged with governance who are not also members of management of the reporting entity.

Review Evidence

1.12 *Review evidence* is the information the accountant uses to provide a reasonable basis for obtaining limited assurance in review engagements. Review evidence is obtained through performance of inquiries and analytical procedures and any other procedures the accountant performs as an integral part of complying with the performance requirements for review engagements.

1.13 In a review engagement, the accountant issues a report stating that he or she is "not aware of any material modifications that should be made to the financial statements" in order for those financial statements to be in conformity with the applicable financial reporting framework. The accountant bases the report on the results of the performance of analytical procedures and the inquiries of the client, along with other procedures performed in the review engagement. In other words, the accountant obtains evidence in order to support the review report.

1.14 This concept is unique to review engagements within SSARSs in that there is no expectation that evidence is obtained in a compilation engagement.

Objectives and Limitations of Compilation and Review Engagements

1.15 When the accountant performs a compilation engagement, the objective is to assist the client in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance about whether material modifications need to be made in the statements for them to be in conformity with the applicable financial reporting framework. Importantly, although compilation engagements are not considered to be assurance engagements in that there is no contemplation that any level of assurance will be obtained in performing those engagements, they are considered to be attest engagements. As such, the independence requirements in the AICPA Code of Professional Conduct (code) are applicable and would need to be considered in order to properly ascertain whether independence has been impaired, which would require a modification of the compilation report. Appendix B, "Compilation Reporting Requirements When Independence Is Impaired," and chapter 3, "Compilation Engagement Reporting Requirements," of this guide provide additional discussion on compilation reporting requirements when an accountant's independence is impaired.

Observations and Suggestions

Paragraph .01 of ET section 92, *Definitions* (AICPA, *Professional Standards*), of the AICPA code defines an attest engagement as "an engagement that requires independence as defined in the AICPA *Professional Standards*." Reviews and compilations are examples of attest engagements.

1.16 Because the accountant does not perform compilation engagements with the objective of obtaining or providing any assurance related to whether the financial statements would need to be modified because of material misstatements, those engagements differ significantly from audit or review engagements. In performing an audit or review engagement, the accountant obtains, depending on the engagement, either reasonable assurance (which is a high level of assurance) or a limited level of assurance that the financial statements are in conformity with the applicable financial reporting framework. In review engagements, the accountant utilizes inquiries, analytical procedures, and other procedures to obtain a limited level of assurance. Because those procedures are used to obtain a level of assurance, they are not required in compilation engagements. Of course, even in nonassurance engagements (that is, compilations), if something comes to the accountant's attention that leads him or her to believe that the statements are materially misstated, the accountant may choose to utilize procedures that generally are associated with assurance engagements (that is, audits or reviews). In any case, the accountant has a professional responsibility to not be associated with financial statements that he or she knows to be misstated or misleading.

1.17 Among other issues to understand in the performance of a compilation engagement is that there is no contemplation that the accountant would need to obtain an understanding of a client's internal control over financial reporting. Additionally, compilations do not contemplate assessments of fraud risks; testing accounting records; observation, confirmation, or examination of source documents; or other procedures that typically are associated with audit engagements. In fact, these audit-specific issues are not even contemplated in the performance of a review engagement, with the objective of obtaining limited assurance related to whether the financial statements are materially misstated.

1.18 Like compilation engagements, when performing review engagements, no requirement exists for the accountant to obtain an understanding of the client's internal control, and the accountant is not required to perform other types of procedures that typically are associated with the performance of audit engagements. With that said, when performing review engagements, the work that the accountant performs in order to obtain limited assurance that the financial statements are prepared in accordance with the applicable financial reporting framework will go beyond the work performed in compilation engagements in which there is no attempt for the accountant to obtain or provide any level of assurance in those engagements.

Ethical Principles and Quality Control Requirements

1.19 In addition to the requirements in SSARSs, when performing a compilation or review engagement (or any professional engagement), the accountant must take into account requirements in the AICPA code. Also, it is important to remember that accountants have a responsibility to adopt a system of quality control in conducting their accounting practice.

1.20 The AICPA code sets out the fundamental ethical principles that all AICPA members are required to observe. Among other things, the AICPA code requires the accountant to maintain integrity and objectivity and be independent in the performance of compilations and reviews, as required by SSARSs.

1.21 A firm's system of quality control needs to cover all attest engagements when those engagements would include audits, reviews, compilations, and other services for which standards have been established by the AICPA Auditing Standards Board or the Accounting and Review Services Committee (ARSC) under Rule 201, *General Standards* (AICPA, *Professional Standards*, ET sec. 201 par. .01), or Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. 01), of the AICPA code. The quality control considerations that need to be addressed related to a firm's compilation and review engagement practice are included in Statement on Quality Control Standards (SQCS) No. 7, *A Firm's System of Quality Control* (AICPA, *Professional Standards*, QC sec. 10A).* For all types of engagements within the scope of SQCS No. 7, the firm needs to establish a system of quality control that is designed to provide reasonable assurance that the firm and its personnel comply with professional standards and applicable regulatory and legal requirements and that the firm issues reports that are appropriate in the circumstances. The system needs to consist of policies designed to achieve those objectives and procedures necessary to implement and monitor compliance with firm policies.

1.22 The nature and extent of a firm's quality control policies and procedures depend on factors such as the size of the firm, the degree of operating

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* Resulting from the Clarity Project, the Auditing Standards Board (ASB), in November 2010, issued Statement on Quality Control Standards (SQCS) No. 8, *A Firm's System of Quality Control (Redrafted)* (AICPA, *Professional Standards*, QC sec. 10). SQCS No. 8 does not change or expand the requirements and guidance contained in SQCS No. 7, *A Firm's System of Quality Control* (AICPA, *Professional Standards*, QC sec. 10A), in any significant respect.

An executive summary of SQCS No. 8 can be found at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/DownloadableDocuments/RecentlyIssuedSQCSs/SQCS_8_Summary.pdf.

Additional information on the ASB's Clarity Project can be found at www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AudAttest/AudAttestStndrds/ASBClarity/Pages/ImprovingClarityASBStandards.aspx.

The provisions of SQCS No. 8 are applicable to a CPA firm's system of quality control for its accounting and auditing practice as of January 1, 2012.

autonomy allowed its personnel and its practice offices, the nature of the practice, firm organization, and appropriate cost-benefit considerations.

Observations and Suggestions

SSARSs provide requirements and other guidance related to how an accountant is to perform and report on compilations and reviews. In contrast, the quality control policies and procedures that the firm adopts may affect how the accountant conducts an individual engagement and the firm's attest practice as a whole. The two sets of literature are interrelated, but they have a different focus.

Importantly, in circumstances in which deficiencies or noncompliance issues are noted related to the firm's system of quality control, that does not necessarily mean that particular compilation or review engagements were not performed in accordance with SSARSs. So, the accountant could perform the compilation or review engagement appropriately and issue the appropriate report, even in circumstances in which deficiencies exist in the firm's quality control system or there was inadvertent noncompliance with one of the firm's established quality control policies or procedures.

Elements of Compilation and Review Engagements

1.23 Without regard to whether the accountant is performing a compilation or review engagement, certain elements of commonality exist related to those engagements. However, because the accountant obtains a limited level of assurance that the financial statements are in accordance with the applicable financial reporting framework in review engagements, certain elements that are applicable to those engagements are above and beyond those that are shared in common with compilation engagements. In this section, elements that are common to, along with elements that differ between, compilation and review engagements are discussed.

Three Party Relationship

1.24 Both compilation and review engagements involve three parties. The first party is management of the reporting entity, at which members of management are responsible for information included in the financial statements, including information in the notes to the financial statements. Secondly, an accountant in the practice of public accountancy, as defined in the AICPA code, is a party to the engagement. Finally, the intended users of the financial statements or financial information, when those users might only be members of management of the entity, are parties to the engagement. Still, in circumstances in which management is the only user, the three party relationship still holds in that management would comprise two of the three parties within the three party relationship.

Observations and Suggestions

A member can only issue a compilation or a review report, or other written communication, using SSARSs' guidance if the member is practicing public accounting, and to do otherwise would not be appropriate. ET section 92 defines the practice of public accounting. That practice would consist of performing for a client, by a member or a member's firm, while holding out to be a CPA, professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by the AICPA Council, including SSARSs, as promulgated by the ARSC. However, a member or a member's firm would not be considered in the practice of public accounting if the member or the member's firm does not perform, for any client, any of these professional services.

Management (Responsible Party)

1.25 Without regard to whether the financial statements are compiled or reviewed, management of the client is responsible for those statements. In addition, management is responsible for the adoption of sound accounting policies and for establishing and maintaining internal control related to initiation, authorization, recording, processing, and reporting of transactions and events or conditions, consistent with their assertions that are embodied within the financial statements.

1.26 Although the accountant certainly is allowed to make recommendations and suggestions related to the form and content of financial statements, as mentioned earlier, management and, when appropriate, those charged with governance are responsible for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. Those same parties are responsible for identifying the framework that will be used in the financial statements. The accountant's responsibility related to the financial statements is clearly stipulated in the compilation or review report.

1.27 During the performance of a compilation or review engagement, the accountant may make suggestions about the form or content of the financial statements or prepare them, in whole or in part, based on information that is the representation of management.

Observations and Suggestions

Accountants may have to educate their clients as to management's responsibilities—especially with respect to engagements to compile financial statements. In many smaller entities, management may feel that as part of the compilation engagement the accountant is taking responsibility for those financial statements. Management needs to understand that although the accountant may prepare the financial statements, in whole or in part, management retains the responsibility for the preparation and fair presentation of those financial statements.

Accountant in the Practice of Public Accounting

1.28 Consistent with paragraph .34 of AR section 60, without regard to whether the financial statements are compiled or reviewed, the accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the client operates that will enable him or her to compile or review financial statements that are appropriate in form for an entity operating in that industry.

1.29 Among other things, SQCS No. 7 requires the accountant's firm, as a matter of quality control, to establish policies and procedures for the acceptance and continuance of client relationships and specific engagements designed to provide the accountant with reasonable assurance that he or she will undertake or continue relationships and engagements only when he or she is competent to perform the engagement and has the capabilities and resources to do so.

1.30 The accountant should not accept an engagement if preliminary knowledge of the engagement circumstances indicates that ethical requirements regarding professional competence will not be satisfied. In some cases, this requirement can be satisfied by using the work of experts. In such cases, the accountant should be satisfied that those persons carrying out aspects of the engagement possess the requisite skills and knowledge and that the accountant has an adequate level of involvement in the engagement and understanding of the work for which any expert is used.

Intended Users of the Financial Statements or Financial Information

1.31 According to paragraph .35 of AR section 60, the intended users include the person, persons, or class of persons who understand the limitations of the compilation or review engagement and financial statements. The accountant has no responsibility to identify the intended users.

1.32 In some cases, intended users (for example, bankers and regulators) may impose a requirement on or request the client to arrange for additional procedures to be performed for a specific purpose. For example, a banker may request that certain agreed-upon procedures be performed with respect to the entity's accounts receivable, in addition to the financial statements being compiled. The accountant can perform additional services in conjunction with the compilation or review, as long as the accountant adheres to professional standards with respect to those additional services.

Observations and Suggestions

SSARSs do not preclude the accountant from performing additional procedures that he or she deems necessary or that the client requests. In such circumstances, the accountant may wish to address the nature of any additional procedures in the engagement letter or in the engagement documentation.

Applicable Financial Reporting Framework

1.33 According to paragraph .37 of AR section 60, management and those charged with governance are responsible for the selection of the entity's applicable financial reporting framework, as well as individual accounting policies, when the financial reporting framework contains acceptable alternatives. The financial reporting framework encompasses financial accounting standards established by an authorized or recognized standards setting organization.

1.34 The requirements of the applicable financial reporting framework determine the form and content of the financial statements. Although the framework may not specify how to account for or disclose all transactions or events, it ordinarily embodies sufficiently broad principles that can serve as a basis for developing and applying accounting policies that are consistent with the concepts underlying the requirements of the framework.

1.35 Examples of financial reporting frameworks include accounting principles generally accepted in the United States of America, as promulgated by the Financial Accounting Standards Board, the Governmental Accounting Standards Board, or the Federal Accounting Standards Advisory Board; IFRSs issued by the IASB; and OCBOA.

Financial Statements or Financial Information

1.36 As stated in paragraph .40 of AR section 60, an accountant may be engaged to compile or review a complete set of financial statements or an individual financial statement (for example, balance sheet only). The financial statements may be for an annual period or for a shorter or longer period, depending on management's needs.

1.37 The requirements of the applicable financial reporting framework determine what constitutes a complete set of financial statements. In the case of many frameworks, financial statements are intended to provide information about the financial position, financial performance, and cash flows of an entity. For example, a complete set of financial statements might include a balance sheet, an income statement, a statement of retained earnings, a cash flow statement, and related notes. For some other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements.

1.38 The preparation of the financial statements requires management to exercise judgment in making accounting estimates that are reasonable in the circumstances, as well as to select and apply appropriate accounting policies. These judgments are made in the context of the applicable financial reporting framework.

Evidence

1.39 As discussed earlier, the objective of a review engagement is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

1.40 According to paragraph .44 of AR section 60, when performing a review engagement, the accountant should perform procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The accountant should apply professional judgment in determining the specific nature, timing, and extent of review procedures. Such procedures should be tailored based on the accountant's understanding of the industry in which the client operates and the accountant's knowledge of the entity. The nature, timing, and extent of procedures for gathering review evidence are deliberately limited, relative to an audit. Review evidence ordinarily can be obtained through analytical procedures and inquiries.

Observations and Suggestions

When the accountant performs permitted nonattest services for a review client, the accountant may use the results of those services in designing the nature, timing, and extent of the review procedures. For example, if the accountant performed bookkeeping services with respect to posting client-approved transactions relevant to certain accounts and believes that such transactions, as a result of the service, are appropriately coded and classified, the accountant may use the results of that service(s) in designing analytical procedures in which those accounts are aggregated at a higher level than if no procedures had been performed.

1.41 When performing a compilation engagement, the accountant has no responsibility to obtain any evidence about the accuracy or completeness of the financial statements. As a result, a compilation does not provide a basis for obtaining any level of assurance on the financial statements being compiled.

Compilation and Review Reports

1.42 A written report or written communication is required for a compilation engagement, unless the accountant withdraws from the engagement. A written report is required for a review engagement, unless the accountant withdraws from the engagement.

1.43 If the accountant's independence is impaired, the accountant may issue a compilation report, provided he or she complies with the compilation standards. If the accountant's independence is impaired, the accountant is precluded from issuing a review report. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA code.

Materiality

1.44 Various financial reporting frameworks include a discussion of materiality within the context of preparing and presenting the financial statements. Generally, those frameworks discuss materiality as follows:

- Misstatements, including omissions from the financial statements, are considered to be material in circumstances when they, either individually or in the aggregate, reasonably could be expected to influence decisions made by users of the statements.
- Judgments related to materiality are made in light of circumstances associated with each particular engagement when those judgments could be affected by the size or nature of the misstatements, or both.
- Judgments focus on matters that could be material to users of financial statements as a group, but what could be material to particular financial statement users generally is not considered.

1.45 In certain circumstances, an accountant might perform a compilation or review engagement when the financial statements are prepared using a framework that does not include particular materiality guidance. For example, if the financial statements are prepared in accordance with an OCBOA, such as income tax basis or cash basis financial statements, those frameworks do not include guidance related to materiality. In circumstances when the applicable financial reporting framework does not provide specific guidance related to materiality consideration, the characteristics previously noted might be helpful as a frame of reference.

1.46 Without regard to whether the engagement is to compile or review financial statements, fundamentally, the accountant's considerations associated with materiality involve professional judgment, along with the accountant's perception about what would be considered material by the users of financial statements as a group. Even so, the accountant may reasonably assume that users

- have a reasonable knowledge of business and economic activities and accounting, along with a willingness to study the information presented in financial statements with a reasonable amount of diligence.
- understand that financial statements are prepared and presented considering materiality judgments.
- recognize that there are inherent uncertainties associated with amounts included in the statements, especially when those amounts are being measured using estimates, judgment, and the consideration of future events.
- make reasonable decisions on the basis of information in the statements.

1.47 The reason that AR section 60 discusses the concept of materiality within the context of a review engagement is because, in addition to the limited level of assurance that is obtained through performance of the engagement, the accountant's review report always has included the notion of materiality related to the potential for uncorrected misstatements to be in the statements. The concept of materiality is included in the first two sentences of the third paragraph in the standard review report:

> Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements.

1.48 Because there is no parallel reporting requirement addressing the concept of materiality in compilation engagements, the AR section 60 discussion of materiality issues is framed within the context of review engagements only. However, as noted previously, materiality issues are important without regard to whether the accountant is compiling or reviewing financial statements.

Chapter 2

Compilation Engagement—Performance Requirements

Introduction

2.01 In a compilation, the objective is to assist management in presenting financial information in the form of financial statements or, when applicable, other specified elements, accounts, or items of a financial statement and pro forma financial information. That is, the accountant's role in a compilation engagement is to take the client's financial data and format that data into a properly structured set of financial statements. Professional standards do not require the accountant to make inquiries or perform other procedures to verify, corroborate, or review the information supplied by the entity. Therefore, the accountant does not obtain or provide any assurance in a compilation engagement and does not report about whether the financial statements are free of material misstatement.

2.02 However, a communication is required for all financial statement compilation engagements. The type of communication depends on whether the accountant (*a*) is engaged to report on compiled financial statements or submits financial statements to a client that are, or reasonably might be, expected to be used by a third party or (*b*) submits financial statements to a client that are not reasonably expected to be used by a third party.

Establishing and Documenting an Understanding With the Client

2.03 The accountant is required to document his or her understanding through a written communication with management (for example, an engagement letter) in a compilation engagement. Doing so helps reduce the likelihood that clients could misunderstand the nature of the services being performed.

Disclosure of the Reasons for a Lack of Independence

2.04 The accountant is permitted, but not required, to disclose a description of the reasons for the lack of independence. Chapter 3, "Compilation Engagement Reporting Requirements," provides a more in-depth discussion of an accountant's reporting requirements in a compilation engagement when independence is impaired.

Submission of Financial Statements

2.05 The concept of submission of financial statements is important in determining the applicability of Statements on Standards for Accounting and Review Services (SSARSs). Specifically, accountants are required to comply with SSARSs whenever they submit financial statements to a client or third parties. Submission of financial statements is deemed to have occurred when the accountant prepares and presents financial statements to management.

Observations and Suggestions

If the subject matter does not consist of *financial statements*, then SSARSs do not apply. The accountant may consider, among other matters, the following attributes when determining whether a financial presentation is a financial statement or a trial balance:

- Generally, a financial statement features the combination of similar general ledger accounts to create classifications or account groupings with corresponding subtotals and totals of dollar amounts. Some examples of these classifications or account groupings are current assets, long-term debt, and revenues. In addition, contra accounts are generally netted against the related primary accounts in financial statement presentations (for example, accounts receivable net of allowance for bad debts). In contrast, a trial balance consists of a listing of all of the general ledger accounts and their corresponding debit or credit balances.
- Financial statements generally contain titles that identify the presentation as one intended to present financial position, results of operations, or cash flows. Typical titles for financial statements include the following:
  - — Balance Sheet
  - — Income Statement or Statement of Operations
  - — Statement of Comprehensive Income
  - — Statement of Retained Earnings
  - — Statement of Cash Flows
  - — Statement of Changes in Owners' Equity or Statement of Changes in Stockholders' Equity
  - — Statement of Assets and Liabilities (with or without owners' equity accounts)
  - — Statement of Revenue and Expenses
  - — Statement of Financial Position
  - — Statement of Activities
  - — Summary of Operations
  - — Statement of Operations by Product Lines
  - — Statement of Cash Receipts and Disbursements

  Examples of typical titles for trial balance presentations are as follows:
  - — Trial Balance
  - — Working Trial Balance
  - — Adjusted Trial Balance
  - — Listing of General Ledger Accounts
- The balance sheet in a set of financial statements segregates asset, liability, and owners' equity accounts and presents these three elements based on the following basic example equation:

Assets = Liabilities + Owners' Equity

The elements of the income statement and their relationship to net income are presented based on the following basic example equation:

Revenues – Expenses + Gains – Losses = Net Income

In a trial balance, no attempt is made to establish a mathematical relationship among the elements except that total debits equal total credits.

- The income statement in a set of financial statements generally contains a caption such as "Net Income" or "Net Revenues Over Expenses" that identifies the net results of operations. Trial balance presentations generally do not contain similar captions.
- The balance sheet in a set of financial statements usually presents assets in the order of their liquidity and liabilities in the order of their maturity. In a trial balance, the accounts are generally listed in account number order as they appear in the general ledger.
- In a set of financial statements, the income statement articulates with the balance sheet because the net results of operations are added to or subtracted from opening retained earnings. In a trial balance, the net results of operations are generally not closed out to retained earnings.

The accountant's use of judgment is important when considering these attributes to determine whether the financial presentation constitutes a financial statement or a trial balance. When making this determination, the accountant may consider the preponderance of the attributes of the financial presentation. For example, a trial balance that contains one or two attributes of a financial statement may, in the accountant's judgment, still constitute a trial balance. When the presentation is deemed to be a financial statement, the accountant, at a minimum, should compile the financial statements in accordance with AR section 80, *Compilation of Financial Statements* (AICPA, *Professional Standards*), when he or she submits such financial statements to his or her client or third parties.

Observations and Suggestions

SSARSs do not define the term *prepared*. Rather, an accountant should use his or her professional judgment in determining whether he or she has prepared a financial statement. The term *presenting* also is not defined in SSARSs. Again, whether an accountant has presented financial statements to a client or third parties is a matter of professional judgment. Physical presentation of printed financial statements normally constitutes presentation. Other situations, especially those involving electronic presentation (for example, via e-mail), may require additional consideration.

2.06 Due to computer technology, it often is unclear whether existing financial statements have been prepared by an accountant or by management. In considering whether the accountant has prepared financial statements, the accountant applies professional judgment to all the facts and circumstances.

If the accountant's work effort results in, or contributes to, the existence of financial statements, the accountant needs to consider whether he or she has, in fact, prepared the financial statements. Consider the following examples:

a. If the accountant takes a client's trial balance and puts the accounts into a format that would represent a financial statement, then the accountant has probably prepared the financial statements. The less the accountant has to do with creating the statements, the less likely the accountant would be deemed to have prepared the statements.

b. The accountant may determine that he or she prepared financial statements even when not so engaged if, as part of an accounting or bookkeeping services engagement, in the accountant's professional judgment, the client reasonably expected that the existing financial statements were prepared as a product of that engagement.

c. If the accountant is intricately involved in adjusting the general ledger and other accounts that are, in turn, presented in a financial statement format, the more likely the accountant may be viewed as preparing the financial statements. On the other hand, if the accountant is not very involved in the accounting process, the less likely that he or she would be deemed to have prepared the financial statements.

d. If all the accounting data resides on the accountant's computer, it is more likely that he or she would be deemed to have prepared the financial statements. However, based on the facts and circumstances of the situation, the accountant may conclude that he or she prepared the financial statements through the use of accounting or bookkeeping software utilized by the client.

2.07 Considerations such as who printed the financial statements or the location at which the accountant's services were performed (for example, at the client's location or the accountant's office) are generally not factors in determining whether the accountant has prepared the financial statements.

2.08 Consider a situation in which the accountant visits a client's office and performs limited work (for example, makes one or two journal entries) on the client's computer system. If the accountant prints out a set of financial statements, has the accountant "prepared" the financial statements (the accountant also would have to present those financial statements in order to be deemed to have submitted the financial statements, thus triggering the SSARSs' requirement that the statements be, at least, compiled)? Alternatively, the accountant might not print out the financial statements as a result of his or her procedures, but the accountant does a substantial amount of work that is necessary in the preparation of the financial statements. If the accountant stops short of actually printing out the statements and then the client prints them at a later date, who "prepared" the financial statements?

2.09 No bright lines and no checklist exist for determining when the accountant has prepared the financial statements. The decision is solely based on the accountant's professional judgment. However, when making the judgment, the accountant may consider the question, If I did not prepare the financial statements, then who did? If it is unreasonable to conclude that the client prepared the statements, the accountant may find that the only reasonable answer is that he or she prepared the financial statements.

Observations and Suggestions

In addition to considering whether the accountant has prepared the financial statements, professional judgment is also necessary in order to consider whether the accountant has presented the financial statements. For example, if the client prepares financial statements in order to facilitate a discussion with the client but the client leaves the meeting without those financial statements, the accountant probably has not presented the financial statements to the client. In that case, SSARSs would not apply. However, in order to avoid any misunderstanding with the client, the accountant may want to include some language in an engagement letter regarding the nonattest service specifically stating that there is no expectation that the accountant will submit financial statements to the client.

Applicability of SSARSs When Performing Controllership or Other Management Services

2.10 If an accountant is in the practice of public accounting as defined by the AICPA's Code of Conduct (code) (paragraph .27 of ET section. 92, *Definitions* [AICPA, *Professional Standards*]) and is not a stockholder, partner, director, officer, or employee of the entity and provides that entity with controllership or other management services that entail the submission of financial statements, the accountant is required to follow the performance and communication requirements of AR section 80, including any requirement to disclose a lack of independence.

Observations and Suggestions

The AICPA code, in paragraph .27 of ET section 92, states that the *practice of public accounting* consists of performance for a client, by a member or a member's firm, while holding out as CPA(s), of professional services of accounting, tax, personal financial planning, litigation support services, and those professional services for which standards are promulgated by bodies designated by the AICPA Council. Such standards include Financial Accounting Standards Board *Accounting Standards Codification*™, Statements on Auditing Standards, SSARSs, Statements on Governmental Accounting Standards, International Financial Reporting Standards and International Accounting Standards, Statements on Standards for Attestation Engagements, and Statements on Standards for Valuation Services.

However, a member or a member's firm, while holding out as CPA(s), is not considered to be in the practice of public accounting if the member or the member's firm does not perform, for any client, any of the professional services described in the preceding paragraph.

2.11 If the accountant is in the practice of public accounting and is also a stockholder, partner, director, officer, or employee of the entity, the accountant may either (*a*) comply with the requirements of AR section 80, or (*b*) communicate, preferably in writing, the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee). The following is an example of the type of communication that may be used by the accountant:

> The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by [*name of accountant*], CPA. I have prepared such financial statements in my capacity [*describe capacity, for example, as a director*] of Company X.

2.12 If an accountant is not in the practice of public accounting, the issuance of a report under SSARSs would be inappropriate; however, the previously mentioned communication may be used.

Applicability of SSARSs to Litigation Services

2.13 SSARSs do not apply to financial statements submitted in conjunction with litigation services that involve pending or potential formal legal or regulatory proceedings before a "trier of fact" in connection with the resolution of a dispute between two or more parties when the

a. service consists of being an expert witness.

b. service consists of being a "trier of fact" or acting on behalf of one.

c. accountant's work under the rules of the proceedings is subject to detailed analysis and challenge by each party to the dispute.

d. accountant is engaged by an attorney to do work that will be protected by the attorney's work product privilege, and such work is not intended to be used for other purposes.

When performing such litigation services, the accountant should comply with Rule 201, *General Standards* (AICPA, *Professional Standards*, ET sec. 201 par. .01), of the AICPA code.

2.14 SSARSs apply to litigation service engagements when the accountant

a. submits unaudited financial statements of a nonissuer that are the representation of management (owners) to others who, under the rules of the proceedings, do not have the opportunity to analyze and challenge the accountant's work, or

b. is specifically engaged to submit, in accordance with SSARSs, financial statements that are the representation of management (owners).

Establishing an Understanding of the Engagement With the Client

2.15 According to paragraph .02 of AR section 80, the accountant should establish an understanding with management regarding the services to be performed for compilation engagements and should document the understanding through a written communication with management. Ordinarily, this written communication will be what most practitioners refer to as *an engagement letter*. Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or to perform certain functions that are management's responsibility. In some cases, the accountant also may establish such an understanding with those charged with governance (for example, the board of directors or a committee of owners).

2.16 The accountant should ensure that the engagement letter includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. Further, the engagement letter should address the following specific items:

- The objective of a compilation is to assist management in presenting financial information in the form of financial statements.
- The accountant will utilize information that is the representation of management (owners) without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.
- Management is responsible for
  - — the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
  - — designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
  - — the prevention and detection of fraud.
  - — identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
  - — making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the financial statements being compiled.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred. The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

- The effect of any independence impairments on the expected form of the compilation report, if applicable, is noted.

2.17 The engagement letter also may include other matters, such as the following:

- A description of the fees and billing policies
- Indemnification clauses for liability arising from knowing misrepresentations by management (regulators may restrict or prohibit such liability limitation arrangements)
- A description of conditions under which access to compilation documentation may be granted to others
- A description of additional services to be provided relating to regulatory requirements

2.18 According to paragraph .05 of AR section 80, if the compiled financial statements are not expected to be used by a third party and the accountant does not expect to issue a compilation report on the financial statements, the accountant should include in the engagement letter an acknowledgment of management's representation and agreement that the financial statements are not to be used by a third party. The engagement letter also should address the following additional matters, if applicable:

- Material departures from the applicable financial reporting framework may exist, and the effects of those departures, if any, on the financial statements may not be disclosed.
- Substantially all disclosures (and statement of cash flows, if applicable) required by the applicable financial reporting framework may be omitted.
- Reference to any supplementary information.

Observations and Suggestions

Although not required by SSARSs, it is considered a best practice that the engagement letter be signed by both the accountant and management or, if applicable, those charged with governance. Additionally, although the accountant is required to establish an understanding with the client for each engagement, the period of engagement is a matter of professional judgment. As such, accountants are not precluded from obtaining an engagement letter covering multiple periods. However, it is recommended that the accountant obtain an engagement letter at least annually as management's understanding of the engagement would tend to erode over time. The accountant may consider discussing the frequency of obtaining engagement letters with his or her legal counsel and liability insurance provider.

Examples of engagement letters for compilation engagements are included at the end of this chapter.

Performance Requirements

2.19 For a compilation engagement, including engagements in which the accountant submits financial statements that are not expected to be used by a third party, the accountant should *a.* have or obtain adequate knowledge and understanding of accounting principles and practices used in the client's industry.

b. have or obtain adequate knowledge and understanding of the client's business and the accounting principles and practices used by the client.

c. read the client's financial statements to consider whether they appear to be appropriate in form and free of material error.

d. perform other procedures if information supplied by the client appears to be incorrect, incomplete, or otherwise unsatisfactory or the accountant believes that the financial statements may be materially misstated.

Understanding of the Industry

2.20 The accountant should possess an understanding of the industry in which the client operates, including the accounting principles and practices generally used in the industry sufficient to enable the accountant to compile financial statements that are appropriate in form for an entity operating in that industry. This means that the accountant should have a sufficient understanding of the industry to know what the financial statements for an entity in that industry should look like and be aware of any accounting principles or practices that are unique to that industry. The accountant does not have to be an industry expert and can obtain this general understanding if the accountant does not already possess it (for example, through AICPA guides, nonauthoritative industry guides, trade publications, and so on).

Knowledge of the Client

2.21 According to paragraph .08 of AR section 80, the accountant should obtain knowledge about the client, including

- an understanding of the client's business and
- an understanding of the accounting principles and practices used by the client.

2.22 In obtaining an understanding of the client's business, the accountant should have a general understanding of the client's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. The accountant's understanding of the entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel.

2.23 In addition, the accountant should obtain an understanding of the accounting principles and practices used by the client in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant's understanding also may include matters such as changes in accounting practices and principles and differences in the client's business model as compared with normal practices within the industry.

2.24 In obtaining this understanding of the client's accounting policies and practices, the accountant should be alert to unusual accounting policies and procedures that come to the accountant's attention as a result of his or her knowledge of the industry.

Reading the Financial Statements

2.25 Before submission, the accountant should read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term *error* refers to mistakes in the preparation of financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosure. Although there is no complete list of the items that the accountant may consider during a technical reading of the financial statements, the following are examples of the types of issues that may be considered as part of the process:

- Are headings on the financial statements appropriate and in accordance with the applicable financial reporting framework (such as the use of the heading "Statement of Cash Receipts and Disbursements" when the cash basis of accounting is used)?
- Are major sections of the financial statements properly captioned (such as the use of "Current" and "Noncurrent" captions on a classified balance sheet)?
- Are accounts grouped in appropriate captions (such as land held for investment classified as "Other Assets")?
- On the basis of titles of transactions, are such transactions properly classified (such as a gain on the sale of property, plant, and equipment classified as a "Nonextraordinary Transaction")?
- Are there arithmetical errors in the financial statements (such as the total of the amounts for items listed under the "Current Assets" category are equal to the total current assets on the balance sheet)?
- Are there clerical mistakes in the financial statements (such as typographical errors)?
- Are there mistakes in the application of accounting principles (such as the reporting of property, plant, and equipment at cost with no accumulated depreciation in a balance sheet purporting to be in accordance with accounting principles generally accepted in the United States of America)?
- Are required financial statement disclosures omitted (such as the omission of the method used to account for inventories in a set of financial statements purporting to be prepared in accordance with accounting principles generally accepted in the United States of America)?

Other Compilation Procedures

2.26 In a compilation engagement, the accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures, often as part of other services performed for the client, such as bookkeeping, payroll, and tax services. The results of these inquiries or procedures, as well as knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to recognize that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory. In some cases, this information may lead the accountant to become aware that fraud or an illegal act may have occurred. In these instances, the accountant should request that management consider the effect of these matters on the financial statements and communicate the results of such consideration to the accountant. Additionally, the accountant should consider the effect of management's conclusions regarding these matters on the accountant's compilation report.

2.27 Per paragraph .13 of AR section 80, there also may be circumstances when the accountant believes that the financial statements may be materially misstated. In these cases, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should withdraw from the engagement.

2.28 The bottom line is that the accountant has an ethical responsibility to not be associated with financial statements that he or she knows to be misleading. For example, say the accountant is engaged to compile the financial statements of XYZ Company. The accountant also is separately engaged to prepare the personal income tax returns of the owner of XYZ Company and her husband. As part of the tax engagement, the accountant becomes aware that the husband owns another company that provides a material amount of management services to XYZ Company. In reading the compiled financial statements, the accountant becomes aware that the related party relationship and transactions are not disclosed properly in the notes to the financial statements. In this case, the accountant should request that the management of XYZ Company consider the disclosure of the related party relationship and transactions in the financial statements and communicate the results of its consideration to the accountant. The accountant should then consider the effect of management's conclusions regarding the disclosure of the related party relationship and transactions on the accountant's compilation report. If the accountant believes that the financial statements are materially misstated, the accountant should obtain additional or revised information regarding the related party relationship or transaction. If the client refuses to provide additional or revised information, the accountant should withdraw from the engagement.

2.29 As an additional example, the accountant may be compiling the financial statements of a small manufacturing company. During the course of the compilation engagement, the accountant becomes aware that the company is being investigated for possible violations of the Fair Labor Standards Act. Because accounting principles generally accepted in the United States of America require disclosure of uncertainties, such as litigation exposure, the accountant requests that management provide additional information with respect to the issue. If management refuses to provide the requested information, the accountant should withdraw from the engagement because the accountant would have no basis for concluding whether the financial statements are misleading or misstated.

Documentation Requirements

2.30 The accountant should prepare documentation in connection with each compilation engagement in sufficient detail to provide a clear understanding of the work performed. Documentation provides the principal support for the representation in the compilation report (or engagement letter) that the accountant performed the compilation in accordance with SSARSs.

Observations and Suggestions

The accountant is not precluded from supporting the compilation engagement by other means, in addition to the compilation documentation. Such other means might include written documentation contained in other engagement files or quality control files (for example, consultation files) and, in limited situations, oral explanations. However, the accountant may want to consider the extent to which oral explanations can serve as documentation because such explanations are limited in their ability to serve as adequate documentation, for example, when dealing with matters such as staff continuity.

2.31 Although the form, content, and extent of documentation depend on the circumstances of the engagement, the methodology and tools used, and the accountant's professional judgment, the accountant's documentation should nevertheless include the following:

a. The engagement letter documenting the understanding with the client.

b. Any findings or issues that, in the accountant's judgment, are significant. This would include, for example, the results of compilation procedures that indicate that the financial statements could be materially misstated, including actions taken to address such findings, and, to the extent that the accountant had any questions or concerns as a result of his or her compilation procedures, how those issues were resolved.

c. Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that came to the accountant's attention.

Accountant's Communications With the Client When the Compiled Financial Statements Are Not Expected to Be Used by a Third Party

2.32 According to paragraph .22 of AR section 80, when the accountant submits compiled financial statements to his or her client that are not expected to be used by a third party, he or she is not required to issue a compilation report. The accountant should include a reference on each page of the financial statements restricting their use, such as "Restricted for Management's Use Only" or "Solely for the information and use by the management of [*name of entity*] and not intended to be and should not be used by any other party."

2.33 In a situation when a client engages an accountant, other than its auditor, to prepare unaudited financial statements on behalf of management and when those financial statements are provided by management to its outside auditor for the purposes of the annual audit, although the client's outside auditor is a third party, the auditor is not deemed to be using the financial statements. The auditor's role is to apply auditing procedures to those statements in order to obtain sufficient appropriate audit evidence to support his or her opinion on those statements. Accordingly, the accountant is not required to issue a compilation report.

Observations and Suggestions

If compiled financial statements that were intended to be presented only to the client's management and to the client's outside auditor are subsequently needed for another purpose such as presentation to a banker or underwriter, the nonreporting exemption provided by SSARSs when compiled financial statements are not expected to be used by a third party would no longer apply.

2.34 If the accountant becomes aware that the financial statements have been distributed to third parties, the accountant should discuss the situation with the client and determine the appropriate course of action, including considering requesting that the client have the statements returned. If the accountant requests that the financial statements be returned and the client does not comply with that request within a reasonable period of time, the accountant should notify known third parties that the financial statements are not intended for third party use, preferably in consultation with his or her attorney.

2.35 For example, assume that the accountant is engaged to compile the monthly financial statements for an entity. The accountant meets each month with the CEO and the board of directors of the entity to review the monthly financial statements. The accountant has concluded that each member of the board of directors performs management functions and, therefore, avails himself or herself of the nonreporting exception provided by SSARSs. If the accountant learns that a monthly set of financial statements was distributed by the CEO or a board member to a third party, such as a bank or customer, the accountant would discuss the situation with the CEO and a representative of the board of directors to review the terms of the engagement letter and the notice at the bottom of the compiled financial statements stating that such financial statements are "For Management Use Only." If, after discussion, the accountant is satisfied that the monthly financial statement was provided to the third party for informational purposes only and that the third party is not making a financial decision, such as a loan based on the information, and the accountant is confident that the submission to a third party is an isolated incident that will not happen again, the accountant would document the conversation with management and the representative of the board and the accountant's conclusions. The accountant may determine not to request that the compiled financial statements be returned. If the situation reoccurs in the future, the accountant may reconsider his or her conclusions and consider issuing a report on the compiled financial statements or withdraw from the engagement.

2.36 As another example, assume that the third party was a banker who used the compiled financial statements to consider extending the entity's line of credit. In that case, the accountant would request that management contact the banker and ask that the financial statements be returned by the banker and document, if appropriate, that the third party is aware that the financial statements were not intended to be used as a basis for any financial decision.

2.37 In these and all cases, the accountant should use professional judgment in determining the appropriate course of action.

Observations and Suggestions

All persons except for members of management are considered third parties in the compilation and review literature. Importantly, unless they also are involved in management of the reporting entity, those charged with governance would constitute third parties. So, for example, it would be inappropriate to use the nonreporting option compilation when financial statements are restricted for management use only if the financial statements will be used by those charged with governance who are not also members of management of the reporting entity.

Communicating to Management and Others

2.38 When evidence or information comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred, in accordance with paragraph .54 of AR section 80, that matter should be brought to the attention of the appropriate level of management. The accountant need not report matters regarding illegal acts that are clearly inconsequential and may reach agreement in advance with the entity on the nature of such items to be communicated. When matters regarding fraud or an illegal act involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or those charged with governance. The communication may be oral or written. If the communication is oral, the accountant should document it. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning from the engagement. Additionally, the accountant should consider consulting with his or her legal counsel whenever any evidence or information comes to his or her attention during the performance of compilation procedures that fraud or an illegal act may have occurred, unless such illegal act is clearly inconsequential.

2.39 The disclosure of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred to parties other than the client's senior management (or those charged with governance, if applicable) ordinarily is not part of the accountant's responsibility and, ordinarily, would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances, a duty to disclose to parties outside of the entity may exist:

a. To comply with certain legal and regulatory requirements

b. To a successor accountant when the successor decides to communicate with the predecessor accountant, in accordance with AR section 400, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*), regarding acceptance of an engagement to compile or review the financial statements of a nonissuer

c. In response to a subpoena

2.40 Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing matters covered by paragraph .54 of AR section 80 with parties outside the client.

Change in Engagement From Audit or Review to Compilation

2.41 The accountant who has been engaged to audit the financial statements of a nonissuer in accordance with auditing standards generally accepted in the United States of America or the accountant who has been engaged to review the financial statements of a nonissuer in accordance with SSARSs may, before the completion of the audit or review, be requested to change the engagement to a compilation of financial statements. A request to change the engagement may result from a change in circumstances affecting the entity's requirement for an audit or review; a misunderstanding regarding the nature of an audit, review, or compilation; or a restriction on the scope of the audit or review, whether imposed by the client or caused by circumstances.

2.42 Before the accountant, who was engaged to perform an audit in accordance with auditing standards generally accepted in the United States of America or a review in accordance with SSARSs, agrees to change the engagement to a compilation, in accordance with paragraph .57 of AR section 80, at least the following should be considered:

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

b. The additional audit or review effort required to complete the audit or review

c. The estimated additional cost to complete the audit or review

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

2.44 In considering the implications of a restriction on the scope of the audit or review, the accountant should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. Nevertheless, when the accountant has been engaged to audit an entity's financial statements and has been prohibited by the client from corresponding with the entity's legal counsel, the accountant ordinarily would be precluded from issuing a compilation report on the financial statements. If in an audit or a review engagement, a client does not provide the accountant with a signed representation letter, the accountant would ordinarily be precluded from issuing a compilation report on the financial statements.

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

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

Compilation of Specified Elements, Accounts, or Items of a Financial Statement

2.47 AR section 110, *Compilation of Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*), establishes requirements and provides guidance related to compilations of specified elements, accounts, or items of a financial statement (hereafter referred to as "elements" or "schedules"). These include, for example, schedules of rentals, royalties, profit participation, or provision for income taxes.

Observations and Suggestions

If a schedule is included with financial statements as supplementary information, the accountant should indicate the degree of responsibility he or she is taking with respect to the supplementary information either in the compilation report on the basic financial statements or in a separate report on the other data. Chapters 3, and 5, "Review Engagement Reporting and Other Communication Requirements," include examples of these reporting alternatives.

2.48 AR section 110 does not preclude an accountant from assisting the client in presenting schedules and other elements and submitting such schedules to the client or to third parties without issuing a compilation report. However, if the accountant assists the client in presenting schedules or other elements, the accountant should consider how the presentation will be used. Although not required, the accountant should consider issuing a compilation report so a user will not infer an unintended level of reliance on the information.

2.49 According to paragraph .06 of AR section 110, when the accountant is engaged to report on one or more compiled elements, the accountant should establish an understanding with management regarding the services to be performed and should document the understanding through a written communication with management. Ordinarily, this written communication will be what most practitioners refer to as an *engagement letter*. In some cases, the accountant also may establish such an understanding with those charged with governance (for example, the board of directors or a committee of owners).

2.50 The accountant should ensure that the engagement letter includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. Further, the engagement letter should address the following specific items:

- The objective of a compilation of specified elements, accounts, or items of a financial statement (schedule) is to assist management in presenting such financial information.
- The accountant will utilize information that is the representation of management (owners) without undertaking to obtain any assurance that there are no material modifications that should be made to the schedule in order for the schedule to be in conformity with the applicable financial reporting framework.
- Management is responsible for

- — the preparation and fair presentation of the schedule in accordance with the applicable financial reporting framework.
- — designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the schedule.
- — the prevention and detection of fraud.
- — identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- — making all financial records and related information available to the accountant.

- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A compilation differs significantly from a review or an audit of a schedule. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the schedule.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred. The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

2.51 An example of an engagement letter for a compilation of specified elements, accounts, or items of a financial statement is presented at the end of this chapter.

2.52 Importantly, the performance and documentation requirements discussed earlier in this chapter would also apply to compilations of schedules and other elements.

Compilation of Pro Forma Financial Information

2.53 AR section 120, *Compilation of Pro Forma Financial Information* (AICPA, *Professional Standards*), establishes requirements and provides guidance related to compilations of pro forma financial information. The objective of pro forma financial information is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. This objective is achieved primarily by applying pro forma adjustments to historical financial information. Pro forma adjustments should be based on management's assumptions and give effect to all significant effects directly attributable to the transaction (or event). Pro forma financial information is commonly used to show the effects of transactions such as the following:

- Business combination
- Change in capitalization
- Disposition of a significant portion of the business
- Change in the form of business organization or status as an autonomous entity
- Proposed sale of securities and the application of the proceeds

Observations and Suggestions

If pro forma financial information is included with financial statements as supplementary information, the accountant should indicate the degree of responsibility he or she is taking with respect to the supplementary information either in the compilation report on the basic financial statements or in a separate report on the other data. Chapters 3 and 5 include examples of these reporting alternatives.

2.54 AR section 120 does not preclude an accountant from assisting the client in presenting pro forma financial information and submitting such information to the client or to third parties without issuing a compilation report. However, if the accountant assists the client in presenting pro forma financial information, the accountant should consider how the presentation will be used. Although not required, the accountant should consider issuing a compilation report so a user will not infer an unintended level of reliance on the information.

2.55 According to paragraph .09 of AR section 120, when the accountant is engaged to report on pro forma financial information, the accountant should establish an understanding with management regarding the services to be performed and should document the understanding through a written communication with management. Ordinarily, this written communication will be what most practitioners refer to as an *engagement letter*. In some cases, the accountant also may establish such an understanding with those charged with governance (for example, the board of directors or a committee of owners).

2.56 The accountant should ensure that the engagement letter includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. Further, the engagement letter should address the following specific items:

- The objective of a compilation of pro forma financial information is to assist management in presenting such financial information.
- The accountant will utilize information that is the representation of management (owners) without undertaking to obtain any

assurance that there are no material modifications that should be made to the pro forma financial information in order for the information to be in conformity with the applicable financial reporting framework.

- Management is responsible for
  - — the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework.
  - — designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.
  - — the prevention and detection of fraud.
  - — identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
  - — making all financial records and related information available to the accountant.
- The accountant is responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.
- A compilation differs significantly from a review or an audit of pro forma financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion or provide any assurance regarding the schedule.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of compilation procedures that fraud or an illegal act may have occurred. The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.
- The effect of any independence impairments on the expected form of the accountant's compilation report, if applicable.

An example of an engagement letter for a compilation of pro forma financial information is presented at the end of this chapter.

2.57 Pro forma financial information should be labeled as such to distinguish it from historical financial information. This presentation should describe the transaction (or event) that is reflected in the pro forma financial information, the source of the historical financial information on which it is based, the significant assumptions used in developing the pro forma adjustments, and any significant uncertainties about those assumptions. The presentation should also indicate that the pro forma financial information should be read in conjunction with the related historical financial information and that the pro forma financial information is not necessarily indicative of the results (such as financial position and results of operations, as applicable) that would have been attained had the transaction (or event) actually taken place earlier.

2.58 Importantly, the historical financial statements of the entity (or, in the case of a business combination, of each significant constituent part of the combined entity) on which the pro forma financial information is based must have been compiled, reviewed, or audited. The accountant's compilation or review report or the auditor's report on the historical financial statements should be included (or incorporated by reference) in the document containing the pro forma financial information.

2.59 Also, keep in mind that the performance and documentation requirements discussed earlier in this chapter would also apply to compilations of pro forma financial information.

Compilation of Personal Financial Statements

2.60 AR section 80 is applicable to compilations of personal financial statements in the same manner as to compilations of financial statements of commercial entities, including all performance and documentation requirements discussed earlier in this chapter. An exhibit at the end of this guide, "Compilations and Reviews of Personal Financial Statements," describes some of the unique accounting considerations related to personal financial statements.

2.61 As discussed earlier in this chapter, paragraph .02 of AR section 80 states that the accountant should establish an understanding with his or her client regarding the services to be performed for compilation engagements and should document the understanding through a written communication with the client. Ordinarily, this written communication will be what most practitioners refer to as an *engagement letter*. An example of an engagement letter for a compilation of personal financial statements is presented in the exhibit at the end of this guide.

2.62 During an engagement to compile personal financial statements, the client makes representations to the accountant, both oral and written. Although the accountant is not required to obtain written representations in an engagement to compile financial statements, given the nature of compilations of personal financial statements, many accountants feel that it is a best practice to obtain written representations in a compilation of personal financial statements. The exhibit at the end of this guide contains an illustration of a client representation letter that may be obtained in a review of personal financial statements. This illustrative client representation letter may be modified as appropriate for those instances in which the accountant decides to obtain a client representation letter in a compilation engagement.

2.63

Illustrative Engagement Letters

Observations and Suggestions

The illustrative engagement letters presented in this guide are intended to show how the engagement letter can be presented assuming that the accountant has been engaged to compile or review the financial statements or financial information. The engagement letter may be modified to include other services that the accountant may be engaged to perform such as nonattest services. In those cases, the engagement letter may include management's acknowledgement of its responsibilities in accordance with Interpretation No. 101-3, "Performance of nonattest services," under Rule 101, *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .05).

Standard Engagement Letter for a Compilation of Annual Financial Statements

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the annual [*and interim, if applicable*] financial statements of XYZ Company as of December 31, 20XX, and issue an accountants' report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

c. preventing and detecting fraud.

d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

> We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

Engagement Letter for a Compilation of 11 Monthly Financial Statements Not Intended for Third Party Use, 3 Quarterly Financial Statements With Substantially All Disclosures Omitted, and Annual Financial Statements

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the following:

- Financial statements of XYZ Company for the months ended January 30, 20XX; February 28, 20XX; March 31, 20XX; April 30, 20XX; May 31, 20XX; June 30, 20XX; July 31, 20XX; August 31, 20XX; September 30, 20XX; October 31, 20XX; and November 30, 20XX, in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA). These financial statements will not be accompanied by a report. Based upon our discussions with you, these statements are for management's use only and are not intended for third party use.
- Financial statements of XYZ Company for the quarters ended March 31, 20XX; June 30, 20XX; and September 30, 20XX, and issue separate accountant's reports thereon in accordance with SSARSs issued by the AICPA. Substantially all disclosures required by [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*] may be omitted.
- The annual financial statements of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with SSARSs issued by the AICPA.

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

c. preventing and detecting fraud.

d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

> We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report on the quarterly and annual financial statements.

If, for any reason, we are unable to complete the compilation of any of your monthly, quarterly, or annual financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

Engagement Letter for a Compilation of Financial Statements Not Intended for Third Party Use

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the [*monthly, quarterly, or other frequency*] financial statements of XYZ Company for the year 20XX.

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

c. preventing and detecting fraud.

d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors, and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

The financial statements will not be accompanied by a report and are for management's use only and are not to be used by a third-party.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

We are not independent with respect to XYZ Company.

Our fees for these services...

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

Engagement Letter for an Engagement to Report on One or More Compiled Specified Elements, Accounts, or Items of a Financial Statement

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, [*identify specified element, account, or item of the financial statement, for example. schedule of accounts receivable, or schedule of depreciation—income tax basis*] of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a compilation is to assist you in presenting financial information in the form of [*identify specified element, account, or item of the financial statement*]. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the [*identify specified element, account, or item of the financial statement*] in order for [*identify specified element, account, or item of the financial statement*] to be in conformity with [*the applicable financial accounting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of [*identify specified element, account, or item of the financial statement*] in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of [*identify specified element, account, or item of the financial statement*].

c. preventing and detecting fraud.

d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the [*identify specified element, account, or item of the financial statement*] being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our compilation procedures, that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

> We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your [*identify specified element, account, or item of the financial statement*], we will not issue a report on such schedule as a result of this engagement.

Our fees for these services. . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

Engagement Letter for an Engagement to Report on Compiled Pro Forma Financial Information

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the pro forma financial information of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a compilation is to assist you in presenting financial information in the form of pro forma financial information. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information in order for the pro forma financial information to be in conformity with [*the applicable financial accounting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the pro forma financial information in accordance with [the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.

c. preventing and detecting fraud.

d. identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial information. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the pro forma financial information being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

> We are not independent with respect to XYZ Company. We will disclose that we are not independent in our compilation report.

If, for any reason, we are unable to complete the compilation of your pro forma financial information, we will not issue a report on such schedule as a result of this engagement.

> Our fees for these services. . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

Chapter 3

Compilation Engagement Reporting Requirements

Introduction

3.01 When the accountant is engaged to report on compiled financial statements or submits financial statements that are reasonably expected to be used by a third party, the financial statements should be accompanied by a written report. The accountant's objective in reporting on the financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements. In addition, each page of the compiled financial statements should include a reference, such as "See Accountant's Compilation Report" or "See Independent Accountant's Compilation Report."

Standard Compilation Report

3.02 According to paragraph .17 of AR section 80, *Compilation of Financial Statements* (AICPA, *Professional Standards*), the basic elements of the report are as follows:

a. A title, such as "Accountant's Compilation Report." The accountant may indicate that he or she is independent in the title, if applicable. Such a title would be "Independent Accountant's Compilation Report."

b. An address that is appropriate in the circumstances of the engagement.

c. An introductory paragraph that

   i. identifies the entity whose financial statements have been compiled.

   ii. states that the financial statements were compiled.

   iii. identifies the financial statements that have been compiled.

   iv. specifies the date or period covered by the financial statements.

   v. includes a statement that the accountant has not audited or reviewed the financial statements and, accordingly, does not express an opinion or provide any assurance about whether the financial statements are in accordance with the applicable financial reporting framework.

d. A statement that management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements.

e. A statement that the accountant's responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the AICPA.

f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

g. The manual or printed signature of the accounting firm or the accountant, as appropriate.

h. The date of the compilation report.

3.03 Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

Observations and Suggestions

When the accountant is reporting on comparative financial statements and the service performed on the statements is different (for example, the financial statements for the current year are reviewed and the statements for the prior year are compiled), the report title may be generic to the level of service (for example, the report could be titled "Independent Accountant's Report"). Illustrative accountant's reports on comparative financial statements are provided in paragraphs 3.35–.36. Appendix C, "Reporting on Compiled or Reviewed Financial Statements For Periods Ended on or After December 15, 2010. With Comparative Financial Statements For Periods Ended Before December 15, 2010," provides additional guidance on an accountant's reporting requirements when reporting on comparative financial statements and the prior compilation was not performed in accordance with SSARS No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*).

Observations and Suggestions

The date of completion of the compilation should be used as the date of the report. Keep in mind that Financial Accounting Standards Board *Accounting Standards Codification* 855, *Subsequent Events*, requires disclosure of the date through which subsequent events have been evaluated. The compilation report date should not be earlier than management's subsequent event note date.

3.04 Illustrative compilation reports are included at the end of this chapter.

Reporting Requirements for Other Comprehensive Basis of Accounting Financial Statements

3.05 Financial statements prepared in accordance with an other comprehensive basis of accounting (OCBOA) are not considered appropriate in form unless the financial statements include

a. a description of the OCBOA, including a summary of significant accounting policies and a description of the primary differences from generally accepted accounting principles (GAAP). The effects of the differences need not be quantified.

b. informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

Observations and Suggestions

Financial statements prepared in accordance with an OCBOA often include a presentation consisting entirely or mainly of cash receipts and disbursements. Such presentations need not conform with the requirements for a statement of cash flows that would be included in a GAAP presentation. Although a statement of cash flows is not required, if a presentation of cash receipts and disbursements is presented in a format similar to a statement of cash flows or if the entity chooses to present such a statement (for example, in a presentation on the accrual basis of accounting used for federal income tax reporting), the statement should either conform to the requirements for a GAAP presentation or communicate their substance. As an example, the statement of cash flows might disclose noncash acquisitions through captions on its face.

Omission of Substantially All Disclosures

3.06 The entity may request that the accountant compile financial statements that omit disclosures. The accountant may compile such financial statements, provided that the omission of the disclosures is not, to his or her knowledge, undertaken with the intention of misleading those who might reasonably be expected to use such financial statements.

Observations and Suggestions

Financial statement disclosures refer to the disclosures required by an applicable financial reporting framework, including disclosures that might appear in the body of the financial statements.

3.07 When reporting on financial statements that omit substantially all disclosures, the accountant should include a paragraph in the compilation report that includes the following elements:

a. A statement that management has elected to omit substantially all the disclosures (and the statement of cash flows, if applicable) required by the applicable financial reporting framework (or ordinarily included in the financial statements if the financial statements are prepared in accordance with an OCBOA)

b. A statement that if the omitted disclosures (and statement of cash flows, if applicable) were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows (or equivalent for presentations other than U.S. GAAP)

c. A statement that, accordingly, the financial statements are not designed for those who are not informed about such matters

3.08 The following is an example of the paragraph the accountant would add as the last paragraph of the compilation report when management has elected to omit substantially all disclosures, but otherwise, the financial statements are in conformity with U.S. GAAP:

> Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

3.09 The following is an example of the paragraph the accountant would add as the last paragraph of the compilation report when management has elected to omit substantially all disclosures, but otherwise, the financial statements are in conformity with the income tax basis of accounting:

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

Departures From the Applicable Financial Reporting Framework

3.10 In the course of compiling the client's financial statements, the accountant may become aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements.

3.11 If the accountant concludes that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided that the accountant states in the report that such determination has not been made.

3.12 Examples of compilation reports that disclose departures from the applicable financial reporting framework are included at the end of this chapter.

Observations and Suggestions

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

Reporting When Not Independent

3.13 When the accountant compiles financial statements for a client in situations in which the accountant is not independent, the report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct. The accountant should indicate his or her lack of independence in a final paragraph of the compilation report. One example of such a disclosure would be

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

3.14 Although the accountant is not required to provide any details regarding the reasons for the independence impairment, he or she may choose to provide a description regarding the reason that his or her independence is impaired. The following are examples of these descriptions:

a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.

b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company.

c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

3.15 According to paragraph .21 of AR section 80, if the accountant chooses to include a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description. The following is an example of a description when there is more than one reason for a lack of independence:

> I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company and I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

Observations and Suggestions

Some accountants are more comfortable simply stating that they are not independent (without disclosing the reasons for the lack of independence). Those accountants are concerned that the disclosure of the reasons may be misinterpreted by the user of the financial statements. Other accountants, however, expressed a desire to be able to describe the reason for the independence impairment. Those accountants felt that the user of the financial statements would be better informed regarding the services provided by the accountant. In the end, it is a matter of professional judgment about which type of disclosure is best suited for the accountant's client and other users of the financial statements.

3.16 Appendix B, "Compilation Reporting Requirements When Independence Is Impaired," to this guide provides additional discussion on compilation reporting requirements when an accountant's independence is impaired. Examples of compilation reports when the accountant's independence has been impaired are included in paragraph 3.32 of this chapter.

Emphasis of a Matter

3.17 Paragraph .25 of AR section 80 states that an accountant may emphasize a matter disclosed in the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. The following guidance is appropriate when the accountant decides to emphasize a matter:

- Emphasis paragraphs should not introduce new information about the financial statements; they should only highlight or emphasize a matter disclosed in the financial statements.
- If the financial statements are deficient or do not contain a needed disclosure and the client does not correct the statements, the accountant is required to state, in a separate paragraph of the report, that the financial statements contain a departure from the applicable financial reporting framework. This required paragraph differs from a voluntary emphasis paragraph.
- Emphasis paragraphs should not contain information about the procedures the accountant has performed or has not performed.
- Emphasis paragraphs should not contain the accountant's conclusions or opinions.
- If the accountant decides to add an emphasis paragraph to highlight a going-concern disclosure in the client's financial statements, the term "substantial doubt" should not be used in that paragraph. "Substantial doubt" is an audit evidence-based concept that should only be used in audit reports.

3.18 When the accountant decides to emphasize a matter, the matter should be described in a separate paragraph added to the standard report. An example of this report is included at the end of this chapter.

Reporting on Supplementary Information

3.19 When the basic financial statements are accompanied by information presented for supplementary purposes, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to such information. When the accountant has compiled both the basic financial statements and other data presented only for supplementary analysis purposes, the compilation report should refer to the other data, or the accountant can issue a separate report on the other data. If a separate report is issued, the report should state that the other data accompanying the financial statements are presented only for the purposes of additional analysis, and that the information has been compiled from information that is the representation of management, without audit or review, and that the accountant does not express an opinion or provide any assurance on such data. Examples of these reporting alternatives are presented at the end of this chapter.

Reporting on Specified Elements, Accounts, or Items of a Financial Statement

3.20 The objective of reporting on one or more compiled specified elements, accounts, or items of a financial statement is to prevent misunderstanding of the degree of responsibility the accountant is assuming when his or her name is associated with the elements, accounts, or items of a financial statement. According to paragraph .11 of AR section 110, *Compilation of Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards*), when the accountant issues a compilation report on one or more specified elements, accounts, or items of a financial statement, the basic elements of the report are as follows:

a. A title, such as "Accountant's Compilation Report." The accountant may indicate that he or she is independent in the title, if applicable. Such a title would be "Independent Accountant's Compilation Report."

b. An address that is appropriate in the circumstances of the engagement.

c. An introductory paragraph that

  i. identifies the entity whose elements, accounts, or items of a financial statement have been compiled.

  ii. states that the specified element(s), account(s), or item(s) have been compiled.

  iii. identifies the specified element(s), account(s), or item(s) that have been compiled.

  iv. specifies the date or period covered by the specified element(s), account(s), or item(s).

  v. includes a statement that the accountant has not audited or reviewed the specified element(s), account(s), or item(s) and, accordingly, does not express an opinion or provide any assurance about whether the specified element(s), account(s), or item(s) are in accordance with the applicable financial reporting framework.

  vi. if the compilation was performed in conjunction with a compilation of the entity's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the specified element(s), account(s), or item(s).

d. A statement that management (owners) is (are) responsible for the preparation and fair presentation of the specified element(s), account(s), or item(s) in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the specified element(s), account(s), or item(s).

e. A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARSs issued by the AICPA.

f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of specified element(s), account(s), or item(s) of a financial statement without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the specified element(s), account(s), or item(s) of a financial statement.

g. The manual or printed signature of the accounting firm or the accountant, as appropriate.

h. The date of the compilation report.

3.21 Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

3.22 Each page of the specified elements, accounts, or items of a financial statement compiled by the accountant should include a reference, such as "See Accountant's Compilation Report."

3.23 An illustrative compilation report on specified elements, accounts, or items of a financial statement is included at the end of this chapter.

Reporting on Pro Forma Financial Information

3.24 The objective of reporting on compiled pro forma financial information is to prevent misunderstanding of the degree of responsibility the accountant is assuming when his or her name is associated with pro forma financial information. According to paragraph .14 of AR section 120, *Compilation of Pro Forma Financial Information* (AICPA, *Professional Standards*), when the accountant issues a compilation report on pro forma financial information, the basic elements of the report are as follows:

a. A title, such as "Accountant's Compilation Report." The accountant may indicate that he or she is independent in the title, if applicable. Such a title would be "Independent Accountant's Compilation Report."

b. An address that is appropriate in the circumstances of the engagement.

c. An introductory paragraph that

   i. identifies the entity whose pro forma financial information has been compiled.

   ii. states that the pro forma financial information has been compiled.

   iii. identifies the pro forma financial information that has been compiled.

   iv. specifies the date or period covered by the pro forma financial information.

   v. references the financial statements from which the historical financial information is derived and includes a statement on whether such financial statements were compiled, reviewed, or audited. (The report on pro forma financial information should refer to any modifications in the accountant's or auditor's report on historical financial statements.)

vi. includes a statement that the accountant has not audited or reviewed the pro forma financial information and, accordingly, does not express an opinion or provide any assurance about whether the pro forma financial information is in accordance with the applicable financial reporting framework.

vii. If the compilation was performed in conjunction with a compilation of the entity's financial statements, the paragraph should so state and indicate the date of the accountant's compilation report on those financial statements. Furthermore, any departure from the standard report on those statements should also be disclosed if considered relevant to the presentation of the pro forma financial information.

d. A statement that management (owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.

e. A statement that the accountant's responsibility is to conduct the compilation in accordance with SSARSs issued by the AICPA.

f. A statement that the objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.

g. The manual or printed signature of the accounting firm or the accountant, as appropriate.

h. The date of the compilation report.

3.25 Procedures that the accountant might have performed as part of the compilation engagement should not be described in the report.

3.26 Each page of the pro forma financial information compiled by the accountant should include a reference, such as "See Accountant's Compilation Report."

3.27 An illustrative compilation report on pro forma financial information is included at the end of this chapter.

Reporting on Prescribed Forms

3.28 AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*), establishes reporting requirements and provides reporting guidance when the accountant is engaged to compile financial statements included in a prescribed form. Paragraph .02 of AR section 300 defines a *prescribed form* as any standard preprinted form designed or adopted by the body to which it is to be submitted. Prescribed forms include, for example, forms used by industry trade associations, credit agencies, banks, and governmental and regulatory bodies other than those concerned with the sale or trading of securities. Importantly, a form designed or adopted by the entity whose financial statements are to be compiled is not considered to be a prescribed form.

3.29 AR section 300 is applicable when the prescribed form or related instructions call for departure from the applicable financial reporting framework by specifying a measurement principle not in conformity with the applicable financial reporting framework or by failing to request the disclosures or presentation required by the applicable financial reporting framework.

Observations and Suggestions

The accountant should not sign a preprinted report form that does not conform to the guidance in AR section 300 or AR section 80, whichever is applicable. If the preprinted report form does not conform to the applicable guidance, the accountant should append an appropriate report to the prescribed form.

3.30 There is a presumption that the information required by a prescribed form is sufficient to meet the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from the applicable financial reporting framework required by the prescribed form or related instructions. However, if the accountant becomes aware of a departure from an applicable financial reporting framework other than departures that may be called for by the prescribed form or related instructions, he or she should follow the guidance in paragraphs .27–.29 of AR section 80 (discussed earlier in this chapter) related to departures from the applicable financial reporting framework.

3.31 Illustrative compilation reports on prescribed forms are included at the end of this chapter.

Reporting on Personal Financial Statements

3.32 When the accountant is engaged to report on compiled personal financial statements or submits personal financial statements that are reasonably expected to be used by a third party, the financial statements should be accompanied by a written report. The accountant's objective in reporting on personal financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements. Paragraph .17 of AR section 80 outlines the basic elements of an accountant's compilation report. If an accountant submits personal financial statements to his or her client that are not expected to be used by a third party, the accountant is not required to issue a compilation report. In those circumstances, the accountant's communication requirements are discussed in paragraphs .22–.24 of AR section 80.

3.33 An illustration of an accountant's standard compilation report on compiled personal financial statements is included in the exhibit, "Compilations and Reviews of Personal Financial Statements," at the end of this guide.

Exhibit 3-1

Comparison of Compilation Reporting Requirements for Compilations of Financial Statements for Periods Ending Prior to December 15, 2010, and Compilations of Financial Statements for Periods Ending on or After December 15, 2010

	Compilation Report on Financial Statements for Periods Ending Prior to December 15, 2010	*Compilation Report on Financial Statements for Periods Ending on or After December 15, 2010*
Title	Not required	Accountant's Compilation Report
Addressee	Not required	[*Appropriate Salutation*]
Introductory paragraph	I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants.	I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.
Paragraph outlining management's responsibilities		Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements.

	Compilation Report on Financial Statements for Periods Ending Prior to December 15, 2010	*Compilation Report on Financial Statements for Periods Ending on or After December 15, 2010*
Paragraph outlining the accountant's responsibilities	None	My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.
Conclusion paragraph	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.	The communication is moved to the introductory paragraph.
Paragraph disclosing independence impairment	I am (We are) not independent with respect to XYZ Company. The accountant is not precluded from disclosing the reasons for the independence impairment.	I am (We are) not independent with respect to XYZ Company. The accountant is not precluded from disclosing the reasons for the independence impairment.

3.34

Illustrative Accountant's Compilation Reports

Financial Statements Prepared in Accordance With U.S. GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements of a Not-for-Profit Entity Prepared in Accordance With U.S. GAAP

Accountant's Compilation Report

Board of Trustees

ABC Organization

I (We) have compiled the accompanying statement of financial position of ABC Organization (a not-for-profit entity) as of June 30, 20XX, and the related statement of activities and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements of a Governmental Entity Prepared in Accordance With U.S. GAAP

Accountant's Compilation Report

Honorable Mayor, Members of the City Council, and Citizens of City of X

City of X, State Y

I (We) have compiled the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of X, State Y, as of and for the year ended June 30, 20XX, which collectively comprise the City's basic financial statements as listed in the table of contents. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

The management of the City of X, State Y, is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The management's discussion and analysis and budgetary comparison information, on pages X through X and XX through XX, are presented for purposes of additional analysis. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. The supplementary information has been compiled from information that is the representation of management. We have not audited or reviewed the supplementary information and accordingly, we do not express an opinion or provide any assurance on such supplementary information.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With the Cash Basis of Accounting

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 20XX, and the related statement of revenue collected and expenses paid for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the cash basis of accounting.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the cash basis of accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With the Income Tax Basis of Accounting

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying statement of assets, liabilities and equity—income tax basis of XYZ Company as of December 31, 20XX, and the related statement of revenue and expenses—income tax basis for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the income tax basis of accounting.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis of accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With International Financial Reporting Standards (IFRSs) as Issued by the International Accounting Standards Board (IASB)

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country—Intended for Use in the United States of America

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*].

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

This report is intended solely for the information and the use of [*specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With IFRSs as Issued by the IASB—Compilation Performed in Accordance With SSARSs and International Standard on Related Services 4410, *Engagements to Compile Financial Statements*

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with the International Standard on Related Services (ISRS 4410) issued by the International Audit & Assurance Standards Board applicable to compilation engagements. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Management Has Elected to Omit Substantially All Disclosures, but the Financial Statements Are Otherwise Prepared in Accordance With U.S. GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Management Has Elected to Omit Substantially All Disclosures, but the Financial Statements Are Otherwise Prepared in Accordance With the Income Tax Basis of Accounting

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying statement of assets, liabilities and equity—income tax basis of XYZ Company as of December 31, 20XX, and the related statement of revenue and expenses—income tax basis for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the income tax basis of accounting.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis of accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

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

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independence Impaired and No Disclosure of the Reason for the Independence Impairment

<u>Accountant's Compilation Report</u>

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

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

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independence Impaired Due to a Financial Interest in the Client and Disclosure of the Reason for the Independence Impairment

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Departure From U.S. GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. During our compilation, I (we) did become aware of a departure (certain departures) from accounting principles generally accepted in the United States of America that is (are) described in the following paragraph.

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

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Departure From the Income Tax Basis of Accounting

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying statement of assets, liabilities and equity—income tax basis of XYZ Company as of December 31, 20XX, and the related statement of revenue and expenses—income tax basis for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the income tax basis of accounting.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis of accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. During our compilation, I (we) did become aware of a departure (certain departures) from the income tax basis of accounting that is (are) described in the following paragraph.

As disclosed in note X to the financial statements, the income tax basis of accounting requires that [*describe requirement*]. Management has informed me (us) that the company has [*describe departure from the income tax basis of* *accounting*]. The effect of this departure on the financial statements has not been determined.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP Accompanied by Supplementary Information Compiled by the Accountant

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The supplementary information appearing on pages XX through XX is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has been compiled from information that is the representation of management. We have not audited or reviewed the supplementary information and, accordingly, do not express an opinion or provide any assurance on such supplementary information.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP Accompanied by Supplementary Information Not Compiled by the Accountant

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The supplementary information included on pages XX through XX is presented for purposes of additional analysis and is not a required part of the basic financial statements. We have not compiled or reviewed the unaudited supplementary information, and, accordingly, do not express an opinion or any form of assurance on it.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Schedule of Accounts Receivable Prepared in Accordance With U.S. GAAP

<u>Accountant's Compilation Report</u>

Board of Directors

XYZ Company

I (We) have compiled the accompanying schedule of accounts receivable of XYZ Company as of December 31, 20XX. I (We) have not audited or reviewed the accompanying schedule of accounts receivable and, accordingly, do not express an opinion or provide any assurance about whether the schedule of accounts receivable is in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the schedule of accounts receivable in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the schedule of accounts receivable.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of a schedule of accounts receivable without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the schedule of accounts receivable.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Schedule of Depreciation Prepared in Accordance With the Basis of Accounting the Entity Uses for Federal Income Tax Purposes

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying schedule of depreciation of XYZ Company as of December 31, 20XX. I (We) have not audited or reviewed the accompanying schedule of depreciation and, accordingly, do not express an opinion or provide any assurance about whether the schedule of depreciation is in accordance with the basis of accounting the Company uses for federal income tax purposes.

Management (Owners) is (are) responsible for the preparation and fair presentation of the schedule of depreciation in accordance with the basis of accounting the Company uses for federal income tax purposes and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the schedule of depreciation.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of a schedule of depreciation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the schedule of depreciation.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Pro Forma Financial Information Reflecting a Business Combination Prepared in Accordance With U.S. GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying pro forma financial information of XYZ Company as of December 31, 20XX, reflecting the business combination of the Company and ABC Company. The historical condensed financial statements are derived from the historical unaudited financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were compiled by another (other) accountant(s).[1] I (We) have not audited or reviewed the accompanying pro forma financial information and, accordingly, do not express an opinion or provide any assurance about whether the pro forma financial information is in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the pro forma financial information in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the pro forma financial information.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of pro forma financial information without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the pro forma financial information.

The objective of this pro forma financial information is to show what the significant effects on the historical financial information might have been had the transaction (or event) occurred at an earlier date. However, the pro forma financial information is not necessarily indicative of the results of operations or related effects on financial position that would have been attained had the transaction (or event) actually occurred earlier.

Paragraph the accountant may add after the previous paragraph when management has elected to omit substantially all disclosures, but the pro forma financial information is otherwise in conformity with U.S. GAAP:

Management has elected to omit all of the disclosures ordinarily included in pro forma financial information. The omitted disclosures might have added significant information regarding the company's pro forma financial position and results of operations. Accordingly, this pro forma financial information is not designed for those who are not informed about such matters.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Prescribed Form That Calls for a Presentation Departure From U.S. GAAP

<u>Accountant's Compilation Report</u>

[*Appropriate Salutation*]

I (We) have compiled the [*identification of financial statements, including period covered and the name of entity*] included in the accompanying prescribed

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[1] When one set of historical financial statements is audited or reviewed and the other is audited, reviewed, or compiled, wording similar to the following would be appropriate:

> The historical condensed financial statements are derived from the historical financial statements of XYZ Company, which were compiled by me (us), and of ABC Company, which were reviewed by another (other) accountant(s), appearing elsewhere herein (or incorporated by reference).

If either accountant's review report or auditor's report includes an explanatory paragraph or is modified, that fact should be referred to within the report.

form. I (We) have not audited or reviewed the financial statements included in the accompanying prescribed form and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements included in the form prescribed by [*name of body*] in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of [*name of body*], and are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America.

This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With a Special Purpose Framework Prescribed by Contract or Regulation and That Framework Prescribes a Format for the Financial Information

Accountant's Compilation Report

[*Appropriate Salutation*]

I (We) have compiled the [*identification of financial statements, including period covered and the name of entity*] included in the accompanying prescribed form. I (We) have not audited or reviewed the financial statements included in the accompanying prescribed form and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with the basis of accounting prescribed by [*describe contract or regulation*].

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements included in the form in accordance with the basis of accounting prescribed by [*describe contract or regulation*] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of [*describe contract or regulation*], and are not intended to be a complete presentation of [*name of entity's*] assets and liabilities.

This report is intended solely for the information and use of [*the specified parties*] and is not intended to be and should not be used by anyone other than these specified parties.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP With Emphasis of a Matter

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

As more fully described in note X to the financial statements, during [*insert period*], XYZ Company changed the estimated useful lives of several depreciable items included in property, plant, and equipment.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

3.35

Illustrative Accountant's Compilation Reports on Comparative Financial Statements—Continuing Accountant

Accountant's Compilation Report on Comparative Financial Statements When a Compilation Has Been Performed for Both Periods

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Report Includes a Changed Reference to a Departure From U.S. GAAP

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

In my (our) report dated March 1, 20X2, with respect to the 20X1 financial statements, I (we) referred to a departure from accounting principles generally accepted in the United States of America because the company carried its land at appraised values. As described in note X, the Company has changed its method of accounting for land and restated its 20X1 financial statements to conform with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When the Accountant's Report on the Prior-Period Financial Statements Is Corrected

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. During our compilations I (we) did become aware of a departure from accounting principles generally accepted in the United States of America that is described in the following paragraphs.

During the compilation of the 20X2 financial statements, I (we) became aware that the 20X1 financial statements contained a departure from accounting principles generally accepted in the United States of America. I was (We were) not aware of the departure from accounting principles generally accepted in the United States of America at the conclusion of my (our) compilation of the 20X1 financial statements and, accordingly did not refer to the departure in my (our) report dated [*insert date*] on the 20X1 financial statements.

As disclosed in note X to the financial statements, investments in marketable equity securities should be reported at fair value. Management of XYZ Company has informed me (us) that these investments were stated at cost in the 20X1 financial statements and that, if accounting principles generally accepted in the United States of America had been followed, the investment in noncurrent marketable equity securities and stockholders' equity as of December 31, 20X1, would have been decreased by $[*amount*]. During 20X2, all investments in marketable equity securities were stated in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Report When the Financial Statements of the Current Year Have Been Compiled and Those of the Prior Year Have Been Reviewed

Accountant's Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the 20X2 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying 20X1 financial statements were previously reviewed by me (us) and I (we) stated that based on my (our) procedures, I was (we were) not aware of any material modifications that should be made to those financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America in my (our) report dated

March 31, 20X2, but I (we) have not performed any procedures in connection with that review engagement since that date.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Report on Comparative Financial Statements When the Financial Statements of the Current Period Have Been Compiled and Those of the Prior Period Have Been Reviewed and a Departure Is Discovered in the Prior-Period Financial Statements

Accountant's Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the 20X2 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying 20X1 financial statements were previously reviewed by me (us) and I (we) stated that based on my (our) procedures, I was (we were) not aware of any material modifications that should be made to those financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America in my (our) report dated March 31, 20X2, but I (we) have not performed any procedures in connection with that review engagement since that date.

During the compilation of the 20X2 financial statements, I (we) became aware that the 20X1 financial statements contained a departure from accounting principles generally accepted in the United States of America As disclosed in note X to the financial statements, investments in marketable equity securities should have been reported at fair value in the financial statements rather than at cost. If accounting principles generally accepted in the United States of America had been followed, the investments in marketable equity securities and stockholders' equity as of December 31, 20X1, would have been decreased by $[*amount*]. However, XYZ Company has restated its 20X1 financial statements to reflect the valuation of its investments in marketable equity securities at fair value in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Audited

<u>Accountant's Report</u>

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The 20X1 financial statements were audited by me (us) and I (we) expressed an unqualified opinion on them in my (our) report dated March 1, 20X2, but I (we) have not performed any auditing procedures since that date.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When Prior-Period Financial Statements That Omit Substantially all Disclosures Have Been Compiled From Previously Reviewed Financial Statements of the Same Period

<u>Accountant's Compilation Report</u>

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

Management has elected to omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

The 20X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all of the disclosures required by accounting principles generally accepted in the United States of America and that I (we) previously reviewed as indicated in my (our) report dated March 1, 20X2.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

3.36

Illustrative Accountant's Compilation Reports on Comparative Financial Statements—Noncontinuing Accountant

Accountant's Compilation Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Compiled by a Predecessor Accountant and the Predecessor's Report Is Not Presented

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America. The financial statements of XYZ Company as of December 31, 20X1, were compiled by other accountants whose report dated February 1, 20X2, stated that they have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the 20X2 compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Reviewed by a Predecessor Accountant and the Predecessor's Report Is Not Presented

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The accompanying financial statements of XYZ Company as of December 31, 20X1, were reviewed by other accountants whose report dated February 1, 20X2, stated that based on their procedures, they are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Audited by a Predecessor Auditor, and the Predecessor's Report Is Not Presented

Accountant's Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

The 20X1 financial statements were audited by other accountants and they expressed an unqualified opinion on them in their report dated March 1, 20X2, but they have not performed any auditing procedures since that date.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Accountant's Compilation Report on Comparative Financial Statements When the Predecessor Accountant's Report Is Not Presented, and the Successor Accountant Is Engaged to Compile the Restatement Adjustment(s)

Accountant's Compilation Report

Board of Directors

XYZ Company

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America. The financial statements prior to adjustment of XYZ Company as of and for the year ended December 31, 20X1, were compiled by other accountants whose report dated February 1, 20X2, stated that they have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

I (We) also compiled the adjustments described in note X that were applied to restate the 20X1 financial statements. I (We) have not audited or reviewed the adjustments described in note X that were applied to restate the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the adjustments described in note X that were applied to restate the 20X1 financial statements are in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Chapter 4

Review Engagement Performance Requirements

Introduction

4.01 In a review engagement, the objective is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. To meet this objective, the accountant accumulates review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements.

4.02 A review engagement essentially consists of four phases. First, the accountant establishes an understanding of the engagement and documents that understanding through a written communication with management (for example, by obtaining an engagement letter). Second, based on the accountant's understanding of the client and industry, he or she tailors the inquiries, analytical procedures, and other review procedures based on his or her understanding of the industry, knowledge of the client, and awareness of the risk that he or she may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated. Third, primarily through the performance of those inquiries and analytical procedures, the accountant gathers evidence to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Finally, based on the review evidence collected, the accountant reports on the financial statements.

Observations and Suggestions

In performing inquiries and analytical procedures, it is important to understand that these procedures should not be performed in a "mechanical" or checklist manner. Rather, both the nature and extent of inquiries and analytical procedures should be tailored based on the accountant's knowledge of the entity, understanding of the industry in which the entity operates, and the accountant's awareness of the risks that he or she may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated. In addition, based on the results of the inquiries and analytical procedures, it is important to consider whether additional, or follow-up, work needs to be performed to obtain limited assurance to allow the accountant to appropriately report on the financial statements.

4.03 A review differs significantly from an audit of financial statements in which the auditor obtains a high level of assurance that the financial statements are free of material misstatement. In a review, the accountant does not have to obtain an understanding of the entity's internal control, assess fraud risk, test accounting records, or perform other procedures ordinarily performed in an audit. Accordingly, in a review, the accountant does not obtain assurance that he or she will become aware of all significant matters that would be disclosed in an audit. Therefore, a review is designed to obtain only limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

Applicability of the Statements on Standards for Accounting and Review Services Literature

4.04 Generally, an accountant who is engaged to review the financial statements of a nonissuer would follow the requirements and guidance contained in the Statements on Standards for Accounting and Review Services (SSARSs) literature. However, in certain circumstances, an accountant who is the auditor of an entity and is requested to review interim financial information would perform the review engagement in accordance with Statement on Auditing Standards (SAS) No. 100, *Interim Financial Information*, as amended (AICPA, *Professional Standards*, AU sec. 722).

4.05 SAS No. 100, as amended[*] would be applicable when

a. the client's latest annual financial statements have been audited by the accountant or a predecessor,

b. the accountant has been engaged to audit the client's current year financial statements or the accountant audited the client's latest annual financial statements and expects to be engaged to audit the current year financial statements, and

c. the client prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

If any of the conditions in the preceding (a)–(c) are not met, the accountant should perform the review in accordance with SSARSs.

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[*] In February 2011, the Accounting and Review Services Committee issued Statement on Standards for Accounting and Review Services (SSARS) No. 20, *Revised Applicability of Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*). SSARS No. 20 is effective for reviews of financial statements for periods beginning after December 15, 2011, with early application permitted. SSARS No. 20 revises the condition in (b)ii of paragraph .01 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), as follows:

a. The entity's latest annual financial statements have been audited by the accountant or a predecessor.

b. The accountant ***either***

i. has been engaged to audit the entity's current year financial statements, or

ii. ~~the accountant~~ audited the entity's latest annual financial statements and, ***when it is expected that the current year financial statements will be audited,*** ~~expects to be engaged to audit the current year financial statements~~ ***the appointment of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review.***

c. The ~~client~~ ***entity*** prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

Key Concepts in the SSARSs Literature

Limited Assurance and Review Evidence

4.06 Paragraph .07 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), states that when performing a review engagement, the accountant should perform procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Review evidence obtained through the performance of analytical procedures and inquiries ordinarily will provide the accountant with a reasonable basis for obtaining limited assurance.

4.07 Therefore, using professional judgment, the accountant should determine the specific nature, timing, and extent of review procedures. For example, review procedures would be tailored based on the accountant's understanding of the industry in which the client operates and the accountant's knowledge of the entity. That knowledge would include the following:

- An understanding of the client's business
- An understanding of the accounting principles and practices used by the client

4.08 Consider the situation in which a client is engaged in complex transactions involving hedging of interest rates, foreign currency, and other risks. The accountant's knowledge of these complex transactions would be considered in developing the appropriate inquiries and analytical procedures.

4.09 To further illustrate, consider the following examples:

Example 1

A construction company's client's CFO is a CPA who was hired from a national firm two years ago. The CFO had five years of experience at the national firm serving construction clients. The review last year (the CFO's first with the client) went well as the CFO prepared the financial statements and supporting data. The accountant had no adjustments or modifications to the financial statements.

In year two, the accountant receives the financial statements, and after discussion with the CFO and the CFO's supervisor, the accountant expects that the risks that there will be any changes to the financial statements are low.

The accountant has received an appropriately signed engagement letter and updated his or her understanding of the industry and the client, including changes that occurred in the client's operations during the year.

The accountant decides to tailor the inquiries by scheduling discussions with several job supervisors outside the accounting area to discuss the status and results of jobs in progress and completed engagements, along with comparisons to project budgets.

The accountant decides to tailor the analytical procedures to review monthly reporting of jobs to look for significant unexplained changes in completion or profit (loss) from month to month during the year. The accountant also plans to perform a detailed account-by-account trial balance comparison with last year's trial balance and this year's budgeted trial balance to identify major fluctuations to investigate and make inquiries about and to consider additional review procedures.

The results of these tailored inquiries and analytical procedures may result in other tailored procedures during the engagement.

Example 2

The client is an auto dealership with several locations operating different franchises. Some of the stores operate as franchisees of a manufacturer and supplier that has indicated it will be discontinuing many of its associated franchise relationships across the country. The accountant may tailor his or her procedures to inquire about whether the dealership has received notification that some of its franchise agreements will be terminated. If some franchise agreements will be terminated, the accountant may then need to further tailor procedures around whether to report discontinued operations, the effects on the client's evaluation of impairment (for example, goodwill, intangibles, long lived assets, and so on), going concern implications, or the costs to exit activities.

Observations and Suggestions

Understanding the concept of *review evidence* will help practitioners understand that a review engagement is an assurance engagement and to understand the consideration of evidence that is required in order to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

Awareness of Risks

4.10 According to paragraph .15 of AR section 90, the accountant should focus the analytical procedures and inquiries in those areas where the accountant believes that there are increased risks of misstatements. The results of the accountant's analytical procedures and inquiries may modify the accountant's risk awareness. For example, the response to an inquiry that cash has not been reconciled for several months may revise the accountant's awareness of risks relative to the cash account.

4.11 The concept of risk awareness is not the same as the consideration of risks in an audit engagement. In an audit engagement, the auditor is required to perform procedures to assess risks. An assessment is not required in a review.

The Concept of Limited Assurance

4.12 When performing review engagements, no requirement exists for the accountant to obtain an understanding of the entity's internal control, and the accountant is not required to perform other types of procedures that typically are associated with the performance of audit engagements in which the auditor obtains a reasonable or high level of assurance that the financial statements are free of material misstatement. With that said, when performing review engagements, the work that the accountant performs in order to obtain a limited level of assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework will go beyond the work performed in compilation engagements in which there is no attempt to obtain any level of assurance in those engagements.

Performance Requirements

4.13 The performance of a review engagement requires that the accountant perform procedures designed to accumulate review evidence sufficient to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Sufficient review evidence can be obtained primarily through analytical procedures and inquiries.

4.14 Although the accountant should apply professional judgment in determining the specific nature, timing, and extent of review procedures, the fundamental steps in the review engagement are as follows:

- Develop an understanding of the accounting principles and practices used in the entity's industry
- Develop a general understanding of the entity's operations, including the entity's business and the accounting principles and practices used by the entity
- Tailor the analytical procedures, inquiries, and other review procedures based on the accountant's understanding of the industry, his or her knowledge of the client, and his or her awareness of the risk that the financial statements may be materially misstated
- Perform appropriate analytical procedures
- Make appropriate inquiries of the entity
- Perform other review procedures as deemed appropriate, if any
- Read the entity's financial statements

Understanding of the Industry

4.15 According to paragraph .08 of AR section 90, to perform a review engagement successfully, the accountant should possess an adequate understanding of the industry in which the client operates, including the accounting principles and practices generally used in the industry, sufficient to assist the accountant with determining the specific nature, timing, and extent of review procedures to be performed. For example, if the client is a real estate developer, the accountant should be aware of the existence and application of specialized accounting methods for real estate developers.

4.16 The performance of a review is premised on the accountant having an adequate understanding of accounting principles and practices of the client's industry. Review procedures can be performed effectively only if the accountant is familiar with the industry-specific accounting principles used by the client. For many review engagements, the client does not use specialized or unique accounting practices. In this case, the knowledge the accountant obtains related to accounting principles generally applicable to all entities is sufficient background to execute a review successfully.

4.17 However, when the client operates in an industry characterized by specialized accounting principles, the accountant should be familiar with that industry's specialized accounting principles, practices, and methods. If the accountant is not already knowledgeable about the industry-specific principles, he or she may obtain an understanding of such principles by referring to appropriate material. For example, the accountant may

- review relevant AICPA Audit and Accounting Guides.
- review industry publications.
- review financial statements of other entities in the same industry.
- consult with other individuals familiar with accounting practices in the industry.
- read periodicals, textbooks, and other publications that discuss financial accounting and reporting practices.
- attend seminars conducted by accounting and industry groups.
- take continuing professional education courses on the subject matter.

Knowledge of the Client

4.18 Fundamental to a successful review is the accountant's understanding of the client's business. According to paragraph .11 of AR section 90, the accountant should have a general understanding of the client's organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses.

4.19 Factors to consider in understanding the organization include the form of business organization, the client's history, and the management structure. Operational characteristics that generally are included in the accountant's understanding are, for example, the client's types of products and services, operating locations, production methods (if applicable), distribution system, compensation methods, and material transactions with related parties. The accountant's understanding of a client's business ordinarily is obtained through experience with the entity or its industry and inquiry of the client's personnel.

4.20 According to paragraph .10 of AR section 90, the accountant should obtain knowledge about the client sufficient to assist the accountant with determining the specific nature, timing, and extent of review procedures to be performed. That knowledge should include the following:

- An understanding of the client's business
- An understanding of the accounting principles and practices used by the client

4.21 The accountant should understand the accounting principles and practices used by the client in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant may obtain an understanding of the accounting policies and procedures used by management through inquiry, the review of client prepared documents, or experience with the client.

4.22 The accountant's understanding may include, for example, policies and procedures related to the following:

- Inventory valuation
- Fixed asset depreciation

- Revenue recognition, including whether the client has a unique revenue recognition policy
- Estimates
- Asset impairment

4.23 The accountant's understanding also may include matters such as changes in accounting practices and principles and differences in the client's business model as compared with normal practices within the industry. In obtaining this understanding of the client's accounting policies and practices, the accountant should be alert to unusual accounting policies and procedures that come to the accountant's attention as a result of his or her knowledge of the industry.

Understanding the Client's Organization

4.24 As part of obtaining knowledge of the client, the accountant should have a general understanding of the client's organization. SSARSs do not elaborate on which specific factors of the client's organization should be understood, but some of the factors the accountant might consider include the following:

- Form of business organization
- Principals involved in the organization
- Organizational chart
- Related party transactions

Form of Business Organization

4.25 The business may be set up as a corporation, a partnership, a sole proprietorship, or some other business form allowed by the state in which the organization is located. Knowledge of the form of business allows the accountant to anticipate how transactions, especially capital transactions, should be recorded and classified. For example, property or cash distributions may be treated as a dividend or withdrawal, depending on whether the organization is a corporation or sole proprietorship. In addition, the business form dictates the form of the equity section of the financial statements.

4.26 In a similar fashion, whether the organization is a taxpaying entity or simply files tax returns for informational purposes may affect the financial statements. For example, for a taxpaying entity, certain transactions must be presented net of tax effects, but an entity that does not pay taxes, such as a partnership, would not present those transactions net of tax.

4.27 The legal form and tax status of an entity also are important when the entity is one of several entities owned by a single investor or the same group of investors. If the accountant is reviewing the financial statements of one of several commonly owned entities, it is imperative that the concept of an accounting entity be clearly identified before financial statements are prepared. For example, the reporting entity may include all businesses owned by the same group of investors, and even though there is no equity interest among the entities, many of the practices used in accounting for consolidating entities must nonetheless be used.

Principals and Key Personnel

4.28 For some engagements, the principals involved and the key personnel may be the same. Knowledge of the principals and key personnel of the organization allows the accountant to assess the level of sophistication those people have with respect to financial reporting. This information also enables the accountant to be alert to related party transactions or conflicts of interest that may affect the financial statements.

Related Party Transactions

4.29 Understanding a client's organization helps the accountant identify any related party transactions. Related party transactions occur when one party to a transaction can impose on the other party contract terms that would not have been acceptable in an arm's-length transaction.

4.30 Factors that may assist the accountant to identify potential related party transactions include, but are not limited to, the following:

- Major sources of financing
- Significant vendors and customers
- Relationships (if any) of key employees to the client
- Relationships (if any) of the client to affiliated companies (through equity investments, common ownership, family ties, and so on)

Understanding the Client's Operating Characteristics

4.31 The accountant should obtain a general understanding of the client's operating characteristics as part of the review engagement. This understanding may include the following:

- Understanding the client's products and services
- Identifying the client's operating locations
- Understanding the client's production methods
- Understanding the client's distribution system
- Understanding the client's compensation methods

4.32 An understanding of a client's operating characteristics can be obtained by making inquiries of the client's principals and key personnel and by observing the client's operations.

Products and Services

4.33 The accountant may want to obtain a list of products sold or services provided and develop knowledge of special accounting or disclosure problems related to the client's products or services.

4.34 For example, some products may be sensitive to technological or style changes and would require the client to consider periodic write-downs based on the lower of cost or market test. Other products may be sold with warranty commitments that require the client to estimate the amount of liability to be recorded. If the client custom builds products for its customers and the products require an extended period of time to complete, then revenue recognition methods specific to long term contracts (that is, contract accounting) may apply.

Operating Locations

4.35 The accountant may want to request a list of business locations and the business activity that occurs at each location. Basically, the accountant would be interested in the accounting related to the activities conducted at each location.

4.36 With respect to physical assets, such as fixed assets and inventories, the client should have adequate controls to reasonably ensure the existence and valuation of such assets. If transactions are authorized or executed, or both, at a location, accounting controls should be in place to record the transactions on a timely basis.

Production Methods

4.37 If the client is a manufacturer, knowledge of production methods is an important part of the accountant's development of an understanding of the client's business. Familiarity with the production process might help the accountant identify factors affecting the financial statements, such as a high level of spoiled goods, the use of returnable containers, the need to estimate the percentage of completion of unfinished goods, and the accounting for by-products. Each of these factors has accounting implications that might be considered in determining whether the client has the capabilities to prepare financial statements that conform to the applicable financial reporting framework.

Distribution System

4.38 A general understanding of the client's distribution system allows the accountant to consider whether there are inventory control problems. For example, the client could be in an industry characterized by consignment contracts. Whether the client is the consignor or the consignee, its accounting system generally should be capable of identifying inventory ownership. On the other hand, if the client has multiple outlets and warehouses, the inventory system generally should be capable of identifying goods in transit at the end of the year in order to execute a proper cutoff.

4.39 In addition, understanding the distribution system gives the accountant insight regarding the location of property, plant, and equipment and accrual procedures for various sales transactions that occur during the period.

Compensation Methods

4.40 Employees may be compensated in a variety of ways other than simple periodic cash payments. For example, key employees may receive stock options or direct distributions of stock. Additionally, some or all employees may be involved in qualified or nonqualified pension plans. Knowledge of the compensation methods the client uses would provide a basis for the accountant to raise questions about whether the client has properly valued and disclosed its compensation methods and, when appropriate, satisfied tax regulations and filed appropriate tax forms.

Understanding the Client's Assets, Liabilities, Revenues, and Expenses

4.41 Developing an understanding of the accounting principles used in the client's industry and a general understanding of the client's business (client's organization and operating characteristics) provides a basis for understanding the nature of the client's assets, liabilities, revenues, and expenses. For example, if the client is in an industry characterized by significant sales returns, the accountant would expect to see not only a sales return and allowance account but also supporting control procedures that suggest a reasonable estimate of the year-end sales returns the client expects to make.

Assets

4.42 Routine accounting procedures are used to properly record and measure an entity's assets and, if appropriate, allocate the cost of certain assets to the income statement. For example, routine cash procedures would include the preparation of bank reconciliations on a timely basis and the surprise counting (by client personnel) of cash funds on hand. Also, less routine procedures would have to be adopted if a considerable amount of the client's inventory is held by consignees.

Liabilities

4.43 Routine procedures for accounting for liabilities might include using a voucher system to control cash disbursements and record liabilities on a timely basis. Less routine procedures may include an assessment of contract liabilities, such as threatened litigation or accounting for finance (capital) leases.

Revenues

4.44 Routine accounting procedures would be expected to record sales when the basis of revenue recognition is the delivery date for the goods. However, if the client is involved in the construction of buildings, equipment, and similar assets that require a long construction period, the client would have to consider whether the percentage-of-completion method is more appropriate than the completed-contract method for revenue recognition. If it is, the client would need to implement estimation procedures to institute this revenue recognition method successfully.

Expenses

4.45 Generally, routine accounting procedures are in place to recognize personnel costs, cost of goods sold, and other operating expenses. However, other transactions, such as defined benefit pension plans and stock compensation plans, require a level of accounting sophistication that cannot be characterized as routine.

Designing and Performing Review Procedures

4.46 According to paragraph .14 of AR section 90, based on the accountant's understanding of the industry, his or her knowledge of the client, and his or her awareness of the risks that he or she may unknowingly fail to modify the accountant's review report on financial statements that are materially misstated, the accountant should design and perform analytical procedures and make inquiries and perform other procedures, as appropriate, to accumulate review evidence in obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

Analytical Procedures

4.47 Analytical procedures are an integral part of a review engagement. In a review, the objectives of analytical procedures are

- to provide review evidence and

- to identify financial statement items that appear to be materially misstated.

4.48 Analytical procedures involve the study, comparison, and evaluation of relationships among financial and nonfinancial data at a point in time and the trend in those relationships over a period of time. A basic premise underlying analytical procedures is that plausible relationships among data may reasonably be expected to exist in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, or misstatements.

4.49 Based on the accountant's understanding of the client, the accountant should perform analytical procedures to determine whether amounts and other information presented in the financial statements appear to be reasonable. Understanding the client usually includes having an awareness of (*a*) broad economic conditions, (*b*) industry-specific conditions, and (*c*) client-specific conditions. For example, if the accountant is aware that the client has built or purchased additional warehouse facilities during the current year, the accountant would expect that depreciation expense would likely increase. If the expectation does not agree with what is recorded in the financial statements, the accountant should inquire about the apparent inconsistency.

4.50 Understanding financial and nonfinancial relationships is essential in planning and evaluating the results of analytical procedures and, generally, requires knowledge of the client and the industry in which the client operates. An understanding of the purposes of analytical procedures and the limitations of those procedures also is important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared with expectations, requires judgment.

Observations and Suggestions

The use of analytical procedures in an audit differs from their use in a review. In an audit, analytical procedures are both an important part of planning the audit engagement and a substantive procedure. Essentially, an auditor is required to utilize analytical procedures in both the planning and overall review stages of all financial statement audits, and these types of procedures also frequently are utilized to complement other substantive procedures used in performing engagements; in very low risk areas, analytical procedures may be the only substantive procedures used related to auditing certain amounts in the financial statements. In a review, the accountant is not required to perform analytical procedures in the planning or overall review stages of the engagement. Instead, the results of the analytical procedures represent review evidence the accountant obtains to support the accountant's review report.

4.51 Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, with expectations the accountant develops. Two general steps in performing analytical procedures are as follows:

- Developing expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates

- Comparing the recorded amounts, or ratios developed from recorded amounts, with the expectations the accountant develops

4.52 The accountant develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the industry in which the client operates and knowledge of the client's business. Following are examples of sources of information for developing expectations:

a. Financial information for comparable prior period(s), giving consideration to known changes

b. Anticipated results (for example, budgets or forecasts, including extrapolations from interim or annual data)

c. Relationships among elements of financial information within the period

d. Information regarding the industry in which the client operates (for example, gross margin information)

e. Relationships of financial information with relevant nonfinancial information (for example, payroll costs to number of employees)

4.53 Examples of analytical procedures the accountant may consider performing in a review of financial statements include, but are not limited to, the following:

- Comparing financial statements with statements for comparable prior period(s)
- Comparing current financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial information with corresponding information in budgets, using expected rates, and financial information for prior periods)
- Comparing current financial information with relevant nonfinancial information
- Comparing ratios and indicators for the current period with expectations based on prior periods (for example, performing gross profit analysis by product line and operating segment using elements of the current financial information and comparing the results with corresponding information for prior periods)
- Comparing ratios and indicators for the current period with those of entities in the same industry
- Comparing relationships among elements in the current financial information with corresponding relationships in the financial information of prior periods (for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables)

4.54 Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer assisted techniques. In addition, analytical procedures may be performed at the financial statement level or the detailed account level.

4.55 Analytical procedures often will provide a basis for additional inquiries because the procedures may bring to the accountant's attention other significant matters affecting the financial statements that might otherwise not have been apparent.

Types of Analytical Procedures

4.56 The accountant can use various types of analytical procedures to evaluate the reasonableness of the financial information, ranging from simple comparisons to complex models involving many relationships and elements of data. The following are the three broad types of analytical procedures commonly used by accountants:

a. *Trend analysis*. The comparison of a recorded amount to the prior year balance or to a trend of balances from two or more periods. A common example is comparing monthly totals for sales for the current and preceding year.

b. *Ratio analysis*. The comparison of a ratio calculated for the current period to a related or similar ratio for a prior period, an industry standard, or a budget. Financial and operating ratios commonly are classified into four major categories: liquidity, profitability, leverage, and activity ratios.

c. *Model-based procedures (reasonableness tests)*. The use of client operating data and the relevant external data (industry information and general economic information) to develop an expectation for the recorded amount. These procedures typically use operating and external data, in addition to financial data, to perform reasonableness tests. For example, the number of employees can be used to determine average wages or vacation pay per employee.

4.57 In practice, a specific analytical procedure may take on characteristics of all three types of procedures (trend analysis, ratio analysis, and reasonableness tests). For example, the results of computing the current ratio (ratio analysis) are compared with current ratios of previous years (trend analysis) and evaluated based on the accountant's understanding of current factors affecting the client's working capital accounts (test of reasonableness).

4.58 Whatever type of analytical procedures is used, these procedures include comparisons of key financial data with

- prior period financial information.
- budgeted and forecasted financial information.
- similar information regarding the industry in which the entity operates.
- nonfinancial information that may affect financial information.

Comparison of Current Financial Data to Prior Periods

4.59 The method most commonly used in practice is comparison with amounts from prior periods. This involves using financial information for the comparable prior period(s) (giving consideration to known changes) to develop expected amounts and comparing these expected amounts with current year recorded amounts.

4.60 A variety of techniques are used to facilitate comparisons, including trend analysis and ratio analysis. Common examples include the following:

- Compare the current year's account balance with that of a prior year
- Compare the detail of the current year's account balance with that of a prior year
- Compare current year ratios with those of the prior year
- Compare current year percentage relationships with previous years

Comparison of Current Financial Data to Budgets and Forecasts

4.61 Although many small businesses do not prepare meaningful budgets or forecasts, comparison with carefully prepared budgets and forecasts may be very effective. Even when financial budgets or forecasts are not prepared, some companies maintain manufacturing or production budgets that may be very effective for certain analytical purposes.

4.62 Keep in mind, however, that management may be motivated to manipulate financial results to meet budgets or forecasts and that budgets or forecasts may be used more for motivational purposes than as realistic expectations.

Comparisons to Industry Data

4.63 Published industry data can provide a rich source of information for analytical procedures. A number of industry trade organizations publish industry data. If the client is a member of an industry trade organization, data may be available directly from the organization. However, if a client differs from the other firms in the industry with respect to such characteristics as ownership or financial structure, product diversity, age of assets, or customer mix, the industry ratios may not be meaningful or may need to be adjusted.

Comparisons Using Nonfinancial Information

4.64 A client may generate a variety of nonfinancial data that may be used to make comparisons with recorded amounts. Examples of this data are as follows:

- Production in units
- Direct labor hours
- Number of sales calls
- Size of sales staff
- Square feet of selling space

4.65 Because nonfinancial operating data often are generated and maintained outside of the accounting department, comparisons involving such data can offer an independent check on the reasonableness of related financial information. Tests involving nonfinancial data are sometimes referred to as reasonableness tests because nonfinancial data are used to determine the reasonableness of amounts recorded in the financial information.

Limitations of Analytical Procedures

4.66 Analytical procedures can provide a useful insight into the evaluation of a client's financial statements in a review engagement; however, like any tool, they have limitations.

Relationship of the Past to the Future

4.67 Analytical procedures, especially those related to trend analysis, are based on past events. What has occurred in the past is not always an indication of what should occur in the current period. The historical ratios and trend analyses can provide some insight into the future but only if they are evaluated in the context of current factors. Analyzing what has happened in the past is necessary and useful in performing analytical procedures, but it is certain that the future environment in which a business must operate will be, to some extent, different from the environment in which it operated in the past.

It Is Still Judgmental

4.68 The performance of analytical procedures obviously results in numbers. The accountant may, for example, compute the current ratio or the debt-to-equity ratio. Though those statistics are verifiable, a tendency exists for the numbers to hide the judgment involved in the process. The purpose of the analysis is not to compute innumerable statistics—that is only a means to an end. The purpose of the analysis is to provide insight into the financial statements. That assessment, although based on quantitative information (the various ratios) and qualitative information (for example, the general economic conditions), is in the final analysis, based on the accountant's informed and overall judgment.

Diversified Businesses

4.69 The computation of analytical procedures previously described assumes that the business operates in one industry. This assumption allows the accountant to compare a business's ratios with those experienced by the industry in which it operates. The assumption makes it easier to evaluate the results of the financial statement analysis in the context of the economics and governmental regulation of a single industry. In reality, many businesses operate in diversified industries. Although diversification is a characteristic of large publicly held companies, closely held companies and other private enterprises also can be involved in disparate business activities.

4.70 When the resources (balance sheets) and activities (income statements) of a diversified business are combined, segments that are performing poorly are combined with highly successful units, and the overall financial information may be misinterpreted. In order to resolve this potential distortion, financial statement information generally should be reported and then analyzed on a disaggregated basis. Ideally, financial statements should be presented for each significant segment of the diversified business. Financial reporting standards require that public companies present information on a segment basis in a note to the financial statements. For a closely held company, the accountant may want to request that the financial information be segregated into business segments, product lines, or some other classification scheme that provides a basis for meaningful analysis.

Practical Guidelines

4.71 The nature, timing, and extent of the analytical procedures are a matter of judgment. In determining the appropriate analytical procedures, the accountant may consider (*a*) the nature and materiality of the items reflected in the financial statements, (*b*) the likelihood of a misstatement in the financial statements, (*c*) knowledge obtained during current and previous engagements, (*d*) the stated qualifications of the client's accounting personnel, (*e*) the extent to which a particular item is affected by management's judgment, and (*f*) inadequacies in the client's underlying financial data. Although professional judgment should be used in the selection of analytical procedures, the accountant might consider the preceding practical guidelines in making the selection.

Level of Detail

4.72 The information that is gathered from applying analytical procedures is quite broad. For this reason, analytical procedures are most useful when they are applied to disaggregated data. For example, it is generally more useful to compute the gross profit margin for a single product line than for the company as a whole. Of course, the level of detail at which the accountant will apply analytical procedures to the financial information depends on the client's data collecting, processing, and storing practices. Analytical procedures may be performed at the financial statement level or the detailed account level.

Estimates

4.73 Accounting estimates lack the precision of financial information that is derived from specific transactions. Ranges of acceptable amounts will be larger for balances based on estimates than for balances based on actual transactions. For example, the amount of revenue a retailer recognizes should be based on the summation of all individual sales made during the period; however, the balance in an estimated warranty liability account will be based on the client's judgment for such factors as rate of product return and estimated cost of future repair work. Generally, an acceptable deviation from the financial statement amount is going to be somewhat larger for the estimated liability than for actual sales.

Developing Expectations

4.74 The development of expectations about a client is highly judgmental. The following fundamental categories of information may assist the accountant in developing expectations about a client:

- Broad economic conditions
- Industry-specific conditions
- Client-specific conditions

Broad Economic Conditions

4.75 Broad economic conditions establish the background for developing expectations concerning a client. Different phases of the regional and national business cycle can have a significant effect on the client and, ultimately, the client's financial statements. For example, if interest rates are on an upward trend, the accountant would expect the client's interest costs (assuming the amount of debt outstanding is relatively stable and its maturity is short term) to increase, compared with the previous year's results.

4.76 Generally, broad economic conditions are not documented in the review documentation; rather, the accountant's awareness of the conditions provides a framework in which more specific information is evaluated. For example, changes in the level of interest rates may be an important factor for a client with significant short term debt. Conversely, for a client with little or no debt or with debt with fixed interest rates, changes in the level of interest rates would not be important in forming expectations about the client's financial statements.

Industry-Specific Conditions

4.77 The conditions that characterize the client's industry provide information that allows the accountant to formulate more detailed expectations about the client. These conditions include the economic cycle of the industry, the maturity of the industry, the pace of technological change within the industry, and relevant governmental regulations. For example, if the client's industry is in the trough of the business cycle, the accountant would expect excess operating capacity to create significant volume variances that would affect the gross profit margin and the client's overall profitability.

4.78 Industry-specific conditions generally are not documented in a review engagement because, like broad economic conditions, they provide the background information for developing expectations about the client. Some of the factors may be relevant to one engagement, but other factors may be relevant to another engagement. Once a specific condition is considered to be relevant to developing an understanding of a client, however, it should be referred to in the evaluation of the results of analytical procedures. For example, if the gross profit percentage has changed significantly since the previous review engagement, the accountant's analysis of the change could focus on the changed level of competition.

Client-Specific Conditions

4.79 Generally, awareness of factors unique to a client is obtained through inquiry or prior knowledge of the client. The accountant may have developed a knowledge of a client's production methods, distribution system, and products and services as a result of having performed prior review engagements and other services for the client. For example, on the basis of prior reviews of a client's financial statements, the accountant might be aware that the client usually makes costing errors when pricing certain raw materials.

Evaluating Actual Results and Expectations

4.80 If analytical procedures performed identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the accountant would investigate these differences by inquiring of management and performing other procedures as necessary in the circumstances. Review evidence relevant to management's responses may be obtained by evaluating those responses, taking into account the accountant's understanding of the entity and its environment, along with other review evidence obtained during the course of the review. Although the accountant is not required to corroborate management's responses with other evidence, the accountant may need to perform other procedures when, for example, management is unable to provide an explanation or the explanation, together with review evidence obtained relevant to management's response, is not considered reasonable.

4.81 Comparing actual results to expectations consists of the accountant developing guidelines on what defines a significant deviation. For example, a client's gross profit percentage might be 47 percent this year compared with 45 percent last year, and the accountant has the expectation that, in general, there is no reason to expect a change in the gross profit percentage. In this case, the 2 percentage point difference may or may not be considered significant, depending on the level of precision of the analysis.

4.82 In determining whether a difference between an actual result and an expectation is significant, the accountant relates the item being analyzed to materiality thresholds established for the engagement. For example, in the case of the gross profit percentage difference of 2 points, the accountant may have determined that an item is potentially material if operating income could be misstated by 7 percent or current assets could be misstated by 10 percent. Initially, the 2 percentage point difference may or may not be treated as an error. If it is determined to be an error, it should be converted to a dollar amount and related to (*a*) operating income (cost of goods sold understated and tax expense understated) and (*b*) current assets (ending inventories overstated).

4.83 The materiality analysis is preliminary and is performed to provide the accountant with some direction. If the assumed error is clearly immaterial, the accountant generally would not investigate the matter further. If the assumed error is material or approaches the materiality threshold, the accountant should perform additional procedures, as discussed in paragraph .21 of AR section 90. In the preceding example of the unexpected increase in the gross profit percentage, the accountant may decide to inquire further about the client's inventory count procedures or perform further analytics on the costing for the inventory summarization.

4.84 The identification of significant differences to be investigated based on the application of analytical procedures concentrates on comparing actual results and expectations, not simply on comparing actual results from comparative years. For example, in computing gross profit percentages, the accountant may discover that the percentage is essentially the same for each year. This does not necessarily mean that the results do not require additional investigation. In the current engagement, the accountant may discover that the gross profit for a line of products is expected to decrease because a competitor began to sell a similar product during the current year. The lack of change in gross profit percentages may indicate an error that could have a material effect on the financial statements.

4.85 The evaluation of the results of applying analytical procedures depends on the materiality of the accounts and transactions being analyzed. Thus, the accountant should utilize professional judgment in selecting analytical procedures for each individual engagement. In other words, usually, no reason exists to apply analytical procedures to items that clearly could not have a material effect on the financial statements. In addition, for those items that have been reviewed by applying other procedures, analytical procedures may not be necessary.

Engagement Efficiency

4.86 In a review engagement, the following steps may help improve efficiency related to analytical procedures:

- Omit or limit comparisons of current year financial data to budgets or forecasts if prior experience with the client has shown that the budgets and forecasts are unreasonable, unrealistic, or do not represent management's best estimate.
- Before spending any amount of time performing analytical procedures involving comparisons with industry data, evaluate if the client's line of business is the same as the industry standards and

whether there is significant variation in the data reported and the structure of the companies.

- When planning analytical procedures, determine the extent and availability of client-prepared financial and operating data and become familiar with such information. Most entities develop a vast amount of information to help management analyze operations and make business decisions. Before spending the time to accumulate and analyze such information, try to obtain any internally prepared management reports and analyses that would serve the same purpose.

4.87 Sometimes, accountants tend to perform an excessive number of analytical procedures and ratios, regardless of their relevance to the engagement. Before performing an analytical procedure or ratio, ask, What type of useful evidence this relationship provide?

4.88 In applying analytical procedures in a review engagement, both effectiveness and efficiency may be achieved by using the following approach:

a. Identify account balances or classes of transactions to which other accounting services (for example, bookkeeping or payroll services) have been applied. Consider the evidence already obtained and whether any material errors are likely to remain. If current and relevant review evidence for those account balances has been obtained from other services to provide limited assurance that they are not materially misstated, do not apply analytical procedures to them.

b. For the remaining account balances, develop expectations for them (for example, using historical trends adjusted for known changes). The precision of analytical procedures will vary, based on the accountant's risk awareness and professional judgment. For larger balances in which the accountant believes there may be higher risks of material misstatement, the accountant may want to design and perform analytical procedures that are more precise in order to obtain review evidence that the account is not materially misstated. For smaller balances or when the risks of material misstatement are lower, the accountant may design and perform analytical procedures that are less precise.

c. Identify immaterial account balances or classes of transactions. Apply no analytical procedures to them.

d. Consider how close the existing account balance or class of transaction comes to the expectation developed in item (b). If the differences are within an acceptable range, based on professional judgment, then no additional evidence ordinarily is needed.

e. If the differences are large, material errors could exist. As a result, the accountant should inquire about valid business reasons for the difference. If the results of inquiry are plausible and agree with other evidence, then no additional evidence may be needed.

f. If additional evidence is needed, apply other procedures or obtain suitable evidence.

Inquiries and Other Review Procedures

4.89 Inquiry is a fundamental technique used in a review engagement to collect information relevant to the financial statements. Although the process of inquiry is simple, successful use of the technique depends on the individual who makes the inquiries. Specifically, the inquiry procedures are most effective when the accountant considers what questions to ask and pursues a significant line of aggressive questioning. The accountant should remain appropriately skeptical. The quality of the review engagement is reduced dramatically if the accountant performs inquiry in a mechanical fashion and accepts responses from client personnel without critical evaluation.

4.90 A variety of questions apply to almost all review engagements. Most of these standard questions are asked in a somewhat formal manner, interviewing appropriate client personnel and recording their responses directly in the review documentation.

4.91 Inquiry certainly is not limited to the formal process previously described. As the accountant becomes aware of a circumstance, fact, or relationship, the accountant will logically see a number of questions that can be asked. On the basis of responses given by the client's personnel, the direction of the questioning may change or it may stop because the accountant is satisfied with the answer. In a review engagement, the inquiry process should be an ongoing activity, reflecting the accountant's inquisitive nature.

4.92 The review engagement does not contain a specific place where inquiry should begin or end. The effectiveness of the review engagement is improved when the accountant remains inquisitive throughout the review engagement, raising appropriate questions and carefully evaluating the responses in the context of the specific engagement. In addition, it is not possible to script the inquiries that should be made in a review engagement. Each engagement is unique, and each practitioner is unique. Nonetheless, effective inquiries are focused and relevant. Asking irrelevant questions results in an inefficient review engagement and, perhaps worse, can damage client confidence.

4.93 In addition, although SSARSs state that the accountant should consider making the inquiries of members of management who have responsibility for financial and accounting matters, the accountant may direct inquiries to others within the entity and those charged with governance, if appropriate.

4.94 Because of the nature of the inquiry technique previously described, no complete list exists of the inquiries that should be made in a review engagement; however, SSARSs specifically identify the following as areas of interest that should be explored with management.

Inquiries Concerning Conformity With the Applicable Financial Reporting Framework

4.95 According to paragraph .19 of AR section 90, the accountant should consider making inquiries regarding whether the financial statements have been prepared in conformity with the applicable financial reporting framework. The accountant also should consider whether there have been changes in the application of accounting principles. If such changes have occurred, follow-up inquiries would assist the accountant in concluding whether the changes are appropriate and, if so, whether the changes have been accounted for and disclosed in a manner consistent with the applicable financial reporting framework.

Inquiries Concerning the Entity's Procedures and Accounting Principles

4.96 As discussed earlier, the accountant's understanding of the entity should include an understanding of the procedures and accounting principles that the client uses. The entity's procedures and accounting principles should be adequate to record, classify, and summarize transactions and accumulate information for disclosure in the financial statements in a manner that conforms to the applicable financial reporting framework. The understanding of the nature of the client's accounts provides the accountant with background to determine whether the procedures and accounting principles used are appropriate for the client's industry.

Recording Transactions

4.97 Inquiries relative to the recording of transactions are focused on how individual transactions are authorized and documented and how those transactions are recorded in a book of original entry. Inquiries that relate to the classification of transactions provide evidence about how transactions are coded and to what extent supporting accounting manuals and descriptions are available that describe what transactions should be processed through a particular account. Inquiries concerning the summarization of transactions address the issue of how books of original entry are used to update the general ledger. Finally, the accountant might also make inquiries about how information is accumulated to provide a basis for disclosures in the financial statements.

Inquiries Concerning Unusual or Complex Situations

4.98 The following are examples of situations that may have an effect on the financial statements about which the accountant would ordinarily inquire:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a business segment
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments
- Adoption of new stock compensation plans or changes to existing plans
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates
- Compliance with debt covenants
- Changes in related parties or significant new related parties
- Material off-balance-sheet transactions, variable interest entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

Inquiries Concerning Significant Transactions

4.99 The accountant should consider inquiring about any significant transactions that occurred or were recognized near the end of the reporting period.

Inquiries Concerning the Status of Uncorrected Misstatements

4.100 The accountant should consider inquiring about the status of uncorrected misstatements identified during the previous period. This may include whether adjustments have been recorded subsequent to a previous engagement and, if so, the amounts recorded and the period in which such adjustments were recorded.

Inquiries Concerning Matters About Which Questions Have Arisen

4.101 The accountant should consider inquiring where questions have arisen in the course of applying the review procedures.

Inquiries Concerning Subsequent Events

4.102 The accountant should consider inquiring about events that occur subsequent to the date of the financial statements that could have a material effect on the financial statements. The accountant would then judge such events to determine whether they require an adjustment to, or a disclosure in, the reviewed financial statements.

Inquiries Concerning Fraud

4.103 The accountant should consider inquiring about management's knowledge of any fraud or suspected fraud affecting the entity involving management or others when the fraud could have a material effect on the financial statements (for example, communications received from employees, former employees, or others).

Inquiries Concerning Significant Journal Entries

4.104 The accountant should consider inquiring about any significant journal entries and other adjustments.

Inquiries Concerning Communications From Regulatory Agencies

4.105 The accountant should consider inquiring about any communications the client has received from regulatory agencies.

Inquiries Concerning Actions Taken by Those Charged With Governance

4.106 As part of the review, the accountant should consider inquiring about actions taken at meetings of shareholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements. Matters that would be relevant include the following:

- Approval of key employee stock option plans
- Approval of officer compensation
- Approval of loan agreements
- Approval of disposition of specific assets or segments of the business
- Declaration of stock, cash, or other dividends

4.107 The accountant ordinarily is not required to corroborate management's responses with other evidence; however, in accordance with paragraph .20 of AR section 90, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and his or her knowledge of the client's business and the industry in which it operates.

Reading the Financial Statements

4.108 When reading the final financial statements to consider whether, on the basis of information coming to the accountant's attention, the financial statements appear to conform to the applicable financial reporting framework, the accountant should use experience and professional judgment to assimilate the information obtained.

4.109 Although there is no set process to follow in determining whether financial statements conform to the applicable financial reporting framework, the following steps illustrate one possible approach. It should be emphasized that the following decision process does not preclude the simultaneous performance of inquiries, analytical procedures, or other procedures that the accountant considers appropriate:

- Does it appear that the client has consistently applied accounting principles used by the industry in preparing its financial statements?
- Does it appear that the client's business transactions are consistent with the industry transactions?
- Are unique industry accounting principles adequately described in the summary of significant accounting policies?
- Does it appear that the client has properly applied other accounting principles in preparing the financial statements?
- If accounting principles were not applied on a consistent basis, do the financial statements appear to reflect the appropriate disclosures and adjustments?
- Do the client's accounts on the financial statements appear consistent with the client's operating characteristics?
- Do the accounting procedures for recording, classifying, and summarizing transactions appear to provide a basis for the actual accounts and disclosures contained in the financial statements?
- Have changes in the client's business activities had an effect on the accounting system, and does it appear that the resulting changes in transactions and accounts have been properly reflected in the financial statements?
- Do the financial statements appear to properly reflect actions taken by the stockholders, board of directors, and other committees?
- Do the financial statements appear to properly reflect events and transactions that occurred after the end of the accounting period but before the completion of the review engagement?

4.110 In addition to the previously illustrated considerations, the accountant may read the financial statements to determine whether they appear to conform to the applicable financial reporting framework. Although there is no complete list of the questions that could be raised during a technical reading of the financial statements, the following are examples of the type of questions that might be raised as part of the process:

- Are headings on the financial statements appropriate, according to the basis of accounting used to prepare the financial statements (such as the use of the heading "Statement of Cash Receipts and Disbursements" when the cash basis of accounting is used)?
- Are major sections of the financial statements properly captioned (such as the use of "Current" and "Noncurrent" captions on a classified balance sheet)?
- Are accounts grouped in appropriate captions (such as land held for investment classified as "Other Assets")?
- On the basis of titles of transactions, are such transactions properly classified (such as a gain on the sale of property, plant, and equipment classified as a "Nonextraordinary Transaction")?
- Are there arithmetical errors in the financial statements (such as the total of the amounts for items listed under the "Current Assets" category are equal to the total current assets on the balance sheet)?
- Are there clerical mistakes in the financial statements (such as typographical errors)?
- Are there mistakes in the application of accounting principles (such as the reporting of property, plant, and equipment at cost with no accumulated depreciation computed)?
- Are financial statement disclosures omitted (such as the omission of the method used to account for inventories)?

Obtain Reports From Other Accountants

4.111 Paragraph .19 of AR section 90 states that the accountant should consider obtaining reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees.

Incorrect, Incomplete, or Otherwise Unsatisfactory Information

4.112 According to paragraph .21 of AR section 90, the results of the accountant's review procedures may cause the accountant to recognize that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory. In some cases, this information may lead the accountant to believe that fraud or an illegal act may have occurred. When the accountant becomes aware that information coming to his or her attention may be incorrect, incomplete, or otherwise unsatisfactory, the accountant should request that management consider the effect of these matters on the financial statements and communicate the results of its consideration to the accountant. Additionally, the accountant should consider how these matters might affect the accountant's review report.

4.113 For example, through inquiry of revenue cutoff procedures and analytical review procedures applied to gross profit percentages and sales to receivable trends, the accountant comes to believe that revenues may be overstated. As a result of believing that a material misstatement may exist, the accountant is required to perform additional procedures deemed necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. In this example, the accountant requests management to investigate and analyze whether subsequent year sales (or perhaps fictitious sales) have been erroneously recorded in the current year. Depending on the information management provides the accountant in response to his or her request, the accountant will use his or her professional judgment to either accept this information as a plausible explanation and then document that as such or, if management's explanation and analysis are not plausible or incomplete, the accountant would perform yet more review procedures. For example, the accountant may decide to review close to year-end and subsequent year sales journals or other client records to determine whether a cutoff misstatement occurred.

Other Review Procedures

4.114 When, after performance of analytical procedures and inquiry procedures, the accountant determines that he or she has not accumulated sufficient review evidence to provide a reasonable basis that he or she has obtained limited assurance that the financial statements are in accordance with the applicable financial reporting framework, the accountant should perform other procedures deemed necessary to obtain such assurance.

Documentation Requirements

4.115 According to paragraph .25 of AR section 90, the accountant should prepare documentation in connection with each review engagement in sufficient detail to provide a clear understanding of the work performed, including the nature, timing, extent, and results of review procedures performed. Documentation provides the principal support for the representation in the review report that the accountant performed the review in accordance with SSARSs and the statement in the review report that, based upon the accountant's review, the accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework. Specifically, the accountant's documentation should provide a clear understanding of the work performed, the review evidence obtained and its source, and the conclusions reached.

Observations and Suggestions

The accountant is not precluded from supporting the review report by other means, in addition to the review documentation. Such other means might include written documentation contained in other engagement files or quality control files (for example, consultation files) and, in limited situations, oral explanations.

4.116 According to paragraph .26 of AR section 90, the form, content, and extent of documentation depend on the circumstances of the engagement, the methodology and tools used, and the accountant's professional judgment. The documentation should include the following:

a. The engagement letter documenting the understanding with the client.

b. The analytical procedures performed, including the following:

   i. The expectations, when the expectations are not otherwise readily determinable from the documentation of the work performed, and the factors considered in the development of the expectations

   ii. Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts

   iii. Management's responses to the accountant's inquiries regarding fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount

c. Any additional review procedures performed in response to significant unexpected differences arising from analytical procedures and the results of such additional procedures.

d. The significant matters covered in the accountant's inquiry procedures and the responses thereto. The accountant may document the matters covered by the accountant's inquiry procedures and the responses thereto through a memorandum, checklist, or other means.

e. Any findings or issues that, in the accountant's judgment, are significant (for example, the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached).

f. Significant unusual matters that the accountant considered during the performance of the review procedures, including their disposition.

g. Communications, whether oral or written, to the appropriate level of management regarding fraud or illegal acts that come to the accountant's attention.

h. The management representation letter.

Illustrative Inquiries

4.117 The following list of inquiries is for illustrative purposes only. These inquiries will not necessarily be applicable in every review engagement, nor are these inquiries meant to be all-inclusive. These illustrative inquiries are not intended to serve as a program or checklist to be utilized in performing a review engagement; rather, they address general areas where inquiries might be made in a review engagement. Also, the accountant may feel that it is necessary to make several inquiries in an effort to answer questions related to the issues addressed in these illustrative inquiries.

- General
    - — Have there been any changes in the entity's business activities?

- — Are there any unusual or complex situations that may have an effect on the financial statements (for example, business combinations, restructuring plans, or litigation)?
- — What procedures are in place related to recording, classifying, and summarizing transactions and accumulating information related to financial statement disclosures?
- — Have the financial statements been prepared in conformity with accounting principles generally accepted in the United States of America (or other applicable financial reporting framework, for example the cash basis or the income tax basis of accounting)? Have there been any changes in accounting principles and the methods of applying those principles? Have voluntary changes in accounting principles been reflected in the financial statements through retrospective application of the new principle in comparative financial statements?
- — Have there been any instances of fraud or illegal acts within the entity?
- — Have there been any allegations or suspicions that fraud or illegal acts might have occurred or might be occurring within the entity? If so, where and how?
- — Are any entities, other than the reporting entity, commonly controlled by the owners? If so, has an evaluation been performed to determine whether those other entities should be consolidated into the financial statements of the reporting entity?
- — Are there any entities, other than the reporting entity, in which the owners have significant investments (for example, variable interest entities)? If so, has an evaluation been performed to determine whether the reporting entity is the primary beneficiary related to the activities of these other entities?
- — Is the reporting entity a general partner in a limited partnership arrangement? If so, has an evaluation been performed to determine whether the limited partnership should be consolidated into the financial statements of the reporting entity?
- — Is the reporting entity a controlling partner in a general partnership arrangement? If so, has an evaluation been performed to determine whether the partnership should be consolidated into the financial statements of the controlling partner?
- — Have any significant transactions occurred or been recognized near the end of the reporting period?

- Cash and Cash Equivalents
  - — Is the entity's policy regarding the composition of cash and cash equivalents in accordance with Financial

Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 230, *Statement of Cash Flows*? Has the policy been applied on a consistent basis? Have there been any changes to withdrawal restrictions related to short term investments that could affect the description and classification of cash equivalents?

- — Are all cash and cash equivalents[1] accounts reconciled on a timely basis?
- — Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made, when necessary?
- — Has there been a proper cutoff of cash receipts and disbursements?
- — Has a reconciliation of intercompany transfers been prepared?
- — Have checks that have been written, but not mailed as of the financial statement date, been properly reclassified into the liability section of the balance sheet?
- — Have material bank overdrafts been properly reclassified into the liability section of the balance sheet?
- — Are there compensating balances or other restrictions on the availability of cash and cash equivalents balances? If so, has consideration been given to reclassifying these amounts as noncurrent assets?
- — Have cash funds been counted and reconciled with control accounts?

- Receivables
  - — Has an adequate allowance for doubtful accounts been properly reflected in the financial statements?
  - — Have uncollectible receivables been written off through a charge against the allowance account or earnings? Are there any customer bankruptcy or liquidity issues that would have a material effect on the financial statements?
  - — Has interest earned on receivables been properly reflected in the financial statements?
  - — Has there been a proper cutoff of sales transactions?
  - — Have there been any changes in major contracts with customers that may affect the classification or valuation of receivables?
  - — Are there receivables from employees or other related parties? Have receivables from owners been evaluated

[1] Cash and cash equivalents include all cash and highly liquid investments that are both (*a*) readily convertible to cash and (*b*) so near to maturity that they present insignificant risk of changes in value because of changes in interest rates, in accordance with the requirements in Financial Accounting Standards Board *Accounting Standards Codification* 230, *Statement of Cash Flows*.

to determine if they should be reflected in the equity section (rather than the asset section) of the balance sheet?

— Are any receivables pledged, discounted, or factored? Are recourse provisions properly reflected in the financial statements?

— Have receivables been properly classified between current and noncurrent?

— Have there been significant numbers of sales returns or credit memoranda issued subsequent to the balance sheet date?

— Is the accounts receivable subsidiary ledger reconciled to the general ledger account balance on a regular basis?

- Inventory

— Are physical inventory counts performed on a regular basis, including at the end of the reporting period? Are the count procedures adequate to ensure an appropriate count? If not, how have amounts related to inventories been determined for purposes of financial statement presentation? If so, what procedures were used to take the latest physical inventory and what date was that inventory taken?

— Have general ledger control accounts been adjusted to agree with the physical inventory count? If so, were the adjustments significant?

— If the physical inventory counts were taken at a date other than the balance sheet date, what procedures were used to determine changes in inventory between the date of the physical inventory counts and the balance sheet date?

— Were consignments in or out considered in taking physical inventories?

— What is the basis of valuing inventory for purposes of financial statement presentation?

— Does inventory cost include material, labor, and overhead, when applicable?

— Has inventory been reviewed for obsolescence or cost in excess of net realizable value? If so, how are these costs reflected in the financial statements?

— Have proper cutoffs of purchases, goods in transit, and returned goods been made?

— Are there any inventory encumbrances?

— Is scrap inventoried and controlled?

— Have abnormal costs related to inventory been expensed as incurred?

- Prepaid Expenses
  - What is the nature of the amounts included in prepaid expenses?
  - How are these amounts being amortized?
- Investments
  - What is the basis of accounting for investments reported in the financial statements (for example, securities, joint ventures, or closely held businesses)?
  - Are derivative instruments properly measured and disclosed in the financial statements? If those derivatives are utilized in hedge transactions, have the documentation or assessment requirements related to hedge accounting been met?
  - Are investments in marketable debt and equity securities properly classified as trading, available-for-sale, and held-to-maturity?
  - How were fair values of the reported investments determined? Have unrealized gains and losses been properly reported in the financial statements?
  - If the fair values of marketable debt and equity securities are less than cost, have the declines in value been evaluated to determine whether the declines are other than temporary?
  - For any debt securities classified as held to maturity, does management have the positive ability and intent to hold the securities until they mature? If so, have those debt securities been properly measured?
  - Have gains and losses related to disposal of investments been properly reflected in the financial statements?
  - How was investment income determined? Is investment income properly reflected in the financial statements?
  - Has appropriate consideration been given to the classification of investments between current and noncurrent?
  - For investments made by the reporting entity, have consolidation, equity, or cost method accounting requirements been considered?
  - Are any investments encumbered?
- Property and Equipment
  - Are property and equipment items properly stated at depreciated cost or other proper value?
  - When was the last time a physical inventory of property and equipment was taken?
  - Are all items reflected in property and equipment held for use? If not, have items that are held for sale been properly reclassified from property and equipment?

— Have gains or losses on disposal of property and equipment been properly reflected in the financial statements?

— What are the criteria for capitalization of property and equipment? Have the criteria been consistently and appropriately applied?

— Are repairs and maintenance costs properly reflected as an expense in the income statement?

— What depreciation methods and rates are utilized in the financial statements? Are these methods and rates appropriate and applied on a consistent basis?

— Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?

— Does the entity have any material lease agreements? If so, have those agreements been properly evaluated for financial statement presentation purposes?

— Are there any asset retirement obligations associated with tangible long lived assets? If so, has the recorded amount of the related asset been increased because of the obligation, and is the liability properly reflected in the liability section of the balance sheet?

— Has the entity constructed any of its property and equipment items? If so, have all components of cost been reflected in measuring these items for purposes of financial statement presentation, including, but not limited to, capitalized interest?

— Has there been any significant impairment in value of property and equipment items? If so, has any impairment loss been properly reflected in the financial statements?

— Are any property and equipment items mortgaged or otherwise encumbered? If so, are these mortgages and encumbrances properly reflected in the financial statements?

- Intangibles and Other Assets

— What is the nature of the amounts included in other assets?

— Do these assets represent costs that will benefit future periods? What is the amortization policy related to these assets? Is this policy appropriate?

— Have other assets been properly classified between current and noncurrent?

— Are intangible assets with finite lives being appropriately amortized?

— Are the costs associated with computer software properly reflected as intangible assets (rather than property and equipment) in the financial statements?

— Are the costs associated with goodwill (and other intangible assets with indefinite lives) properly reflected as intangible assets in the financial statements? Has amortization ceased related to these assets?

- Has there been any significant impairment in value of these assets? If so, has any impairment loss been properly reflected in the financial statements?
- Are any of these assets mortgaged or otherwise encumbered?

- Accounts and Short-Term Notes Payable and Accrued Liabilities
  - Have significant payables been reflected in the financial statements?
  - Are loans from financial institutions and other short term liabilities properly classified in the financial statements?
  - Have there been any changes in major contracts with suppliers that may affect the classification or valuation of payables?
  - Have significant accruals (for example, payroll, interest, provisions for pension and profit sharing plans, or other postretirement benefit obligations) been properly reflected in the financial statements?
  - Has a liability for employees' compensation for future absences been properly accrued and disclosed in the financial statements?
  - Are any liabilities collateralized or subordinated? If so, are those liabilities disclosed in the financial statements?
  - Are there any payables to employees and related parties?

- Long-Term Liabilities
  - Are the terms and other provisions of long-term liability agreements properly disclosed in the financial statements?
  - Have liabilities been properly classified between current and noncurrent?
  - Has interest expense been properly accrued and reflected in the financial statements?
  - Is the company in compliance with loan covenants and agreements? If not, is the noncompliance properly disclosed in the financial statements?
  - Are any long-term liabilities collateralized or subordinated? If so, are these facts disclosed in the financial statements?
  - Are there any obligations that, by their terms, are due on demand within one year from the balance sheet date? If so, have these obligations been properly reclassified into the current liability section of the balance sheet?

- Income and Other Taxes
  - Do the financial statements reflect an appropriate provision for current and prior year income taxes payable?
  - Have any assessments or reassessments been received? Are there tax authority examinations in process?
  - Are there any temporary differences between book and tax amounts? If so, have deferred taxes on these differences been properly reflected in the financial statements?
  - Do the financial statements reflect an appropriate provision for taxes other than income taxes (for example, franchise, sales, and so on)?
  - Have all required tax payments been made on a timely basis?
  - Has the entity assessed uncertain tax positions and related disclosures in accordance with FASB ASC 740, *Income Taxes*?
- Other Liabilities, Contingencies, and Commitments
  - What is the nature of the amounts included in other liabilities?
  - Have other liabilities been properly classified between current and noncurrent?
  - Are there any guarantees, whether written or oral, whereby the entity must stand ready to perform or is contingently liable related to the guarantee? If so, are these guarantees properly reflected in the financial statements?
  - Are there any contingent liabilities (for example, discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims)? Are there any potential unasserted claims? Are these contingent liabilities, claims, and assessments properly measured and disclosed in the financial statements?
  - Are there any material contractual obligations for construction or purchase of property and equipment or any commitments or options to purchase or sell company securities? If so, are these facts clearly disclosed in the financial statements?
  - Is the entity responsible for any environmental remediation liability? If so, is this liability properly measured and disclosed in the financial statements?
  - Does the entity have any agreement to repurchase items that previously were sold? If so, have the repurchase agreements been taken into account in determining the appropriate measurements and disclosures in the financial statements?
  - Does the entity have any sales commitments at prices expected to result in a loss at the consummation of the

sale? If so, are these commitments properly reflected in the financial statements?

  - Are there any violations or possible violations of laws or regulations, the effects of which should be considered for financial statement accrual or disclosure?

- Equity
  - What is the nature of any changes in equity accounts during each reporting period?
  - What classes of stock (other ownership interests) have been authorized?
  - What is the par or stated value of the various classes of stock (other ownership interests)?
  - Do amounts of outstanding shares of stock (other ownership interests) agree with subsidiary records?
  - Have pertinent rights and privileges of ownership interests been properly disclosed in the financial statements?
  - Does the entity have any mandatorily redeemable ownership interests? If so, have these ownership interests been evaluated so that a proper determination has been made related to whether these ownership interests should be measured and reclassified to the liability section of the balance sheet? Are redemption features associated with ownership interests clearly disclosed in the financial statements?
  - Have dividend (distribution) and liquidation preferences related to ownership interests been properly disclosed in the financial statements?
  - Do disclosures related to ownership interests include any applicable call provisions (prices and dates), conversion provisions (prices and rates), unusual voting rights, significant terms of contracts to issue additional ownership interests, or any other unusual features associated with the ownership interests?
  - Are syndication fees properly reflected in the financial statements as a reduction of equity (rather than an asset)?
  - Have any stock options or other stock compensation awards been granted to employees or others? If so, are these options or awards properly measured and disclosed in the financial statements?
  - Has the entity made any acquisitions of its own stock? If so, are the amounts associated with these reacquired shares properly reflected in the financial statements as a reduction in equity? Is the presentation in accordance with applicable state laws?
  - Are there any restrictions or appropriations on retained earnings or other capital accounts? If so, are these restrictions or appropriations properly reflected in the financial statements?

- Revenue and Expenses
  - — What is the entity's revenue recognition policy? Is the policy appropriate? Has the policy been consistently applied and appropriately disclosed?
  - — Are revenues from sales of products and rendering of services recognized in the appropriate reporting period (that is, when the products have been delivered and when the services have been performed)?
  - — Were any sales recorded under a "bill and hold" arrangement? If yes, have the criteria been met to record the transaction as a sale?
  - — Are purchases and expenses recognized in the appropriate reporting period (that is, matched against revenue) and properly classified in the financial statements?
  - — Do the financial statements include discontinued operations, items that might be considered extraordinary, or both? If so, are amounts associated with discontinued operations, extraordinary items, or both properly displayed in the income statement?
  - — Does the entity have any gains or losses that would necessitate the display of comprehensive income (for example, gains or losses on available for sale securities or cash flow hedge derivatives)? If so, have these items been properly displayed within comprehensive income (rather than included in the determination of net income)?
- Other
  - — Have events occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements?
  - — Has the entity considered whether declines in market values subsequent to the balance sheet date may be permanent or caused the entity to no longer be in compliance with its loan covenants, or both?
  - — Have actions taken at meetings of stockholders, directors, committees of directors, or comparable meetings that affect the financial statements been reflected in the financial statements?
  - — Are significant estimates and material concentrations (for example, customers or suppliers) properly disclosed in the financial statements?
  - — Are there plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities reflected in the financial statements?
  - — Have there been any material transactions between or among related parties (for example, sales, purchases, loans, or leasing arrangements)? If so, are these transactions properly disclosed in the financial statements?

— Are there uncertainties that could have a material effect on the financial statements? Is there any change in the status of previously disclosed material uncertainties? Are all uncertainties, including going concern matters, that could have a material effect on the financial statements properly disclosed in the financial statements?

— Are barter or other nonmonetary transactions properly recorded and disclosed? Have nonmonetary asset exchanges involving commercial substance been reflected in the financial statements at fair value? Have nonmonetary asset exchanges not involving commercial substance been reflected in the financial statements at carrying value?

Illustrative Analytics

4.118 The purpose of the documentation guidance presented here is to illustrate how the accountant might document expectations in a review engagement. The examples are presented for illustrative purposes only and should not be considered to represent either minimum or maximum documentation requirements.

Expectations

4.119 Forming expectations is an integral phase of the analytical procedures process. *Expectations* are the accountant's predictions of recorded amounts or ratios developed from recorded amounts. In performing analytical procedures, the accountant develops expectations in such a way that material differences between the expectations and the recorded amounts or ratios developed from those recorded amounts are not indicative of possible misstatements, and therefore, the accountant should obtain explanations for the differences (for example, an unusual event occurred). Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant's understanding of the client and the industry in which the client operates. The accountant should select from a variety of data sources to form expectations. For example, the accountant may use prior period information (adjusted for expected changes), management's budgets or forecasts, industry data, or nonfinancial data. Additionally, information that is developed when the accountant compiles interim financial statements can be utilized in developing expectations associated with the review of financial statements.

4.120 The accountant cannot, under any circumstances, perform effective analytical procedures without first developing expectations related to the results of those analytical procedures. Expectations the accountant develops in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.

4.121 The accountant should document expectations when significant expectations are not otherwise readily determinable from the documentation of the work performed and the factors considered in the development of the expectations.

4.122 The following represents examples of how the accountant may document expectations. These examples are not intended to be all inclusive.

4.123

Example 1: Expected Increase in Revenue

The accountant is engaged to review the financial statements of a company that manufactures components that are utilized by other companies in customizing vehicles for use by the U.S. military. Because of various conflicts occurring in the world and the U.S.'s role in those conflicts, the accountant reasonably expects sales to increase. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 10 percent to 15 percent increase in sales. Further, the accountant concludes that receivables should increase and that loans payable and interest expense also would increase because the client would need to borrow money to fund the additional production.

Sample documentation

Teemickmag Military Supply Company

Analytical Procedures

For the year ended December 31, 20XX

Expectations

The following are factors that should affect the relationship between current and prior year amounts:

- Increase in military spending by the government due to world events should result in an increase in sales. Expected increase is between 10 percent and 15 percent. The accountant expects a similar increase in accounts receivable.
- Because of an increase in production of military vehicles, the company had to borrow additional funds. Therefore, expected increase in loans payable and interest expense is between 10 percent and 15 percent.
- No significant change in either days sales in inventory or inventory turnover is expected. Although a build-up in inventory is expected, that build-up is not expected to correspond with the increase in sales because the vehicles are expected to be sold near the date of completion. Any change greater than 5 percent will be subjected to additional inquiries.

Balance sheets and income statements are available for the current year and the two years prior to the current year.

	Trend Analysis			
	Current Year	*Prior Year*	*Change*	*% Change*
Sales	$2,500,000	$2,175,000	$325.000	14.94%
Cost of goods sold	1,780,000	1,566,000	214,000	13.67%
Gross margin	720,000	609,000		
Gross margin as a % of sales	28.80%	28.00%		
Selling expenses	230,000	184,000	46,000	25.00%
Interest expense	48,000	42,000	6,000	14.29%

	Balance Sheet Ratio Analysis		
	Current Year	*Prior Year*	*Two Years Prior*
Accounts receivable, net	$1,100,000	$843,000	$703,000
Inventory	1,000,000	832,000	694,000
Loans payable	498,000	437,000	418,000

<u>Days sales in receivables</u>

Days sales in receivables = Accounts receivable, net at end of period / (Net sales / 365)

Current year days sales in receivables = $1,100,000 / ($2,500,000 / 365) = 161 days

Prior year days sales in receivables = $843,000 / ($2,175,000 / 365) = 141 days

The increase of 20 days sales in receivables (161 days – 141 days) represents a 14 percent increase. Because this increase is within the expected range, no further inquiry is necessary.

<u>Days sales in inventory</u>

Days sales in inventory = Inventory at the end of period / (Total cost of goods sold / 365)

Current year days sales in inventory = $1,000,000 / ($1,780,000 / 365) = 205 days

Prior year days sales in inventory = $832,000 / ($1,566,000 / 365) = 194 days

The increase of 11 days sales in inventory (205 days – 194 days) represents a 6 percent increase. Because this increase is greater than expected, the accountant should inquire of the client and document the reason for the unexpected increase.

<u>Inventory turnover</u>

Inventory turnover = Cost of goods sold / Average inventory

Current year inventory turnover = $1,780,000 / (($1,100,000 + 832,000) / 2) = 1.84 times

Prior year inventory turnover = $1,566,000 / (($832,000 + 694,000) / 2) = 2.05 times

The inventory turnover decreased 10 percent; therefore, because this decrease is greater than expected, the accountant should inquire of the client and document the reason for the unexpected decrease.

The preceding documentation would be adequate. Further, after performing the trend analysis, the accountant concludes that sales, costs of goods sold, and interest expense are all reasonable, given the expectations associated with these amounts. In addition, with respect to balance sheet accounts, the increase in loans payable also is reasonable (14 percent increase) when considered with the corresponding increase in interest expense and the expectation associated with the loan payable account; however, because selling expenses increased by 25 percent, the accountant should inquire of the client and document the reason for that unexpected increase (actual increase does not correspond to expected increase).

4.124

Example 2: Expected Decrease in Revenue

The accountant is engaged to review the financial statements of a client that owns and manages a shopping mall. Due to a poor economy, the mall lost tenants during the year; as such, the accountant reasonably expects revenue to decrease. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 5 percent to 10 percent decrease in revenue during the year. Further, the accountant expects that general and administrative expenses should increase due to an increase in leasing and sales expenses and that management fees should decrease due to a decrease in tenants in the building.

Sample documentation

Pearl River Mall

Analytical Procedures

For the year ended December 31, 20XX

Expectations

The following are factors that should affect the relationship between current and prior year amounts:

- Loss of tenants due to poor economy should result in a decrease in revenue. Expected decrease is between 5 percent and 10 percent.
- Because of the increased number of vacancies, general and administrative expenses are expected to increase because of an increase in leasing and sales expenses. Expected increase is between 5 percent and 10 percent (corresponds with the decrease in revenue).
- Because of the decrease in the number of tenants in the building, management fees are expected to decrease between 5 percent and 10 percent (corresponds with decrease in revenue).

Balance sheets and income statements are available for the current year and the two years prior to the current year.

	Trend Analysis			
	Current Year	*Prior Year*	*Change*	*% Change*
Total revenue	$7,223,000	$8,603,000	$(1,380,000)	(16.04)%
Costs and expenses: management fees	339,000	387,000	(48,000)	(12.40)%
General and administrative	583,000	511,000	72,000	14.09%

Similar balance sheet analytics should be performed as those performed in the preceding example 1.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant should inquire and document why the decrease in tenant revenue, the decrease in management fees, and the increase in general and administrative expenses exceeded expectations.

4.125

Example 3: No Significant Change in Revenue or Expenses Expected

The accountant is engaged to review the financial statements of a small, privately held client in the candy store business. The accountant has performed a review of the financial statements of the candy store for each of the past five years with no significant change in revenue or expenses in any of those years. The accountant expects that trend to continue.

Sample documentation

Mom and Pop Candy Store

Analytical Procedures

For the year ended December 31, 20XX

Expectations

- Based on discussions with the owner-manager, no significant changes from prior year amounts are expected.
- All increases and decreases greater than 5 percent will be subjected to additional inquiries.

	Trend Analysis			
	Current Year	*Prior Year*	*Change*	*% Change*
Sales	$44,000	$39,000	$5,000	12.82%
Cost of goods sold	32,500	31,000	1,500	4.84%
Gross margin	11,500	8,000		
Gross margin as a % of sales	26.14%	20.51%		
Operating expenses	5,200	4,500	700	15.56%
Net income	6,300	3,500		

Similar balance sheet analytics should be performed as those performed in the preceding example 1.

The preceding documentation would be adequate; however, the results of the analytical procedures do not agree with the documented expectations associated with those procedures. Therefore, the accountant may deem it appropriate to inquire and document why sales increased by an amount greater than expected. In addition, the accountant should inquire about why there was not a comparable increase in cost of goods sold. Also, the accountant should discuss with the owner-manager why there is a greater than expected increase in operating expenses and document the results of the discussion.

4.126

Example 4: Expected Changes in Construction Contracts

The accountant is engaged to review the financial statements of a general construction contractor primarily engaged in the construction of commercial office buildings. The accountant has performed the review of this company's financial statements for several years and expects that the current project in process should yield a 5 percent gross profit margin, consistent with similar projects in the past and in accordance with the initial project estimate.

Sample documentation

ABC Construction Contractors

Analytical Procedures

For the Year Ended December 31, 20XX

Expectations

- Based upon discussions with the project manager, it is believed that the gross margin will be consistent with the 5 percent margin achieved in the past and in accordance with the initial project estimate.
- Any deviation in the margin greater than 1 percent will be subjected to additional inquiries.

	Trend Analysis			
Building Contract	*Current Year*	*Prior Year*	*$ Change*	*% Change*
Contract value	$5,000,000	$5,000,000		
Estimated costs at completion	4,900,000	4,750,000	$150,000	3.15%
Planned profit	100,000	250,000	150,000	60.00%
Costs incurred	2,500,000	1,000,000		
Profit recognized contract to date	50,000	50,000		

The preceding documentation indicates that the profit margin on the contract has slipped from 5 percent to 2 percent. Additionally, in accordance with the cost-to-cost method of percentage of completion accounting, it now appears that all of the contract profit was recognized in year one. This may indicate a potential error in the original estimate or a project that is quickly running over budget. The result may be a reversal of profits recognized in earlier periods under the percentage of completion method of contract revenue recognition or a potential loss contract. Further inquiry of management should be considered to discuss potential project issues that will negatively affect profit recognition in the financial statements.

Chapter 5

Review Engagement Reporting and Other Communication Requirements

Introduction

5.01 In a review engagement, the objective is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. Several communication requirements are part of this engagement, including the understanding with the client, the management representation letter, and the review report. The primary purpose of the report is to prevent misinterpretation of the degree of responsibility the accountant is assuming when the accountant's name is associated with the financial statements. In addition, other forms of communication reduce the risks that the accountant or entity may misinterpret the needs or expectations of the other party.

Establishing an Understanding of the Engagement With the Client

5.02 According to paragraph .03 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), the accountant should establish an understanding with management regarding the services to be performed for review engagements and should document the understanding through a written communication with management. Ordinarily, this written communication will be what most practitioners refer to as an engagement letter. Such an understanding reduces the risk that the accountant or management may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or to perform certain functions that are management's responsibility.

Observations and Suggestions

In some cases, the accountant also may establish such an understanding with those charged with governance (for example, the board of directors or a committee of owners). With that said, for many smaller clients, the accountant probably will find that those charged with governance also are involved in managing the entity, so that the governance group and management group are one in the same.

5.03 The accountant should ensure that the engagement letter includes the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. Further, the engagement letter should address the following specific items:

- The objective of a review is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework.

- Management is responsible for
  - the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
  - designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
  - the prevention and detection of fraud.
  - identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
  - making all financial records and related information available to the accountant.
- Management will provide the accountant, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.
- The accountant is responsible for conducting the engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the AICPA.
- A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management.
- A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, the accountant will not express an opinion regarding the financial statements as a whole.
- The engagement cannot be relied upon to disclose errors, fraud, or illegal acts.
- The accountant will inform the appropriate level of management of any material errors and of any evidence or information that comes to the accountant's attention during the performance of review procedures that fraud or an illegal act may have occurred. The accountant need not report any matters regarding illegal acts that may have occurred that are clearly inconsequential and may reach agreement in advance with the entity on the nature of any such matters to be communicated.

5.04 The engagement letter also may include other matters, such as the following:

- A description of the fees and billing policies

- Indemnification clauses for liability arising from knowing misrepresentations by management (regulators may restrict or prohibit such liability limitation arrangements)
- A description of conditions under which access to review documentation may be granted to others
- A description of additional services to be provided relating to regulatory requirements

5.05 The engagement letter also should address the following additional matters, if applicable:

- Material departures from the financial reporting framework may exist, and the effects of those departures, if any, on the financial statements may not be disclosed.
- Reference to supplementary information.

Observations and Suggestions

The engagement letter essentially represents the contract for services between the accountant and the client. Although no requirement of SSARSs exists to do so, it is recommended that the engagement letter be signed by both the accountant and management or, if applicable, those charged with governance.

5.06 An example of an engagement letter for a review of financial statements is presented at the end of this chapter.

Management Representations

5.07 According to paragraph .22 of AR section 90, a management representation letter is required in a review engagement. The representation letter should include, but not be limited to, the following:

- An acknowledgment by management that it bears the responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
- A statement by management that it believes that the financial statements are fairly presented in accordance with the applicable financial reporting framework.
- An acknowledgement by management of its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
- An acknowledgement by management of its responsibility to prevent and detect fraud.
- A statement by management of its knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others.

- A statement by management that it has made full and truthful responses to all inquiries posed by the accountant.
- A statement by management regarding the completeness of information provided to the accountant.
- A statement by management that events that have occurred subsequent to the balance sheet date have been appropriately reflected in the financial statements.

5.08 Generally, the representation letter, which should be addressed to the accountant, is signed by the CEO and CFO or those with equivalent responsibilities. For owner-managed entities, the owner-manager generally would be the person who signs the representation letter.

5.09 Written representations are required from management for all financial statements and periods covered by the review report. For example, if comparative financial statements are reported, the representations obtained at the completion of the most recent review should address all periods being reported. If the client's current management was not in place during the previous year(s) reported, the accountant should nonetheless obtain representations from the current management on all periods covered by the review report.

5.10 The specific written representations obtained will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. The following are examples of conditions (and the resultant representation) of which the accountant may become aware during the review engagement:

General

Condition	*Illustrative Examples*
The effect of a new accounting principle is not known.	We have not completed the process of evaluating the impact that will result from adopting Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) Accounting Standards Update (ASU) No. [*20XX-XX*], as discussed in note X. The company is therefore unable to disclose the impact that adopting FASB ASC ASU No. [*20XX-XX*] will have on its financial position and the results of operations when such statement is adopted.
Justification exists for a change in accounting principles.	We believe that [*describe the newly adopted accounting principle*] is preferable to [*describe the former accounting principle*] because [*describe management's justification for the change in accounting principles*].
Financial circumstances are strained, with disclosure of management's intentions and the entity's ability to continue as a going concern.	Note X to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans.

General

Condition	*Illustrative Examples*
The possibility exists that the value of specific significant long lived assets or certain identifiable intangibles may be impaired.	We have reviewed long lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances have indicated that the carrying amount of its assets might not be recoverable and have appropriately recorded the adjustment.
The entity has a variable interest in another entity.	Variable interest entities (VIEs) and potential VIEs and transactions with VIEs and potential VIEs have been properly recorded and disclosed in the financial statements in accordance with generally accepted accounting principles. We have considered both implicit and explicit variable interests in (*a*) determining whether potential VIEs should be considered VIEs, (*b*) calculating expected losses and residual returns, and (*c*) determining which party, if any, is the primary beneficiary. We have provided you with lists of all identified variable interests in (*a*) VIEs, (*b*) potential VIEs that we considered but judged not to be VIEs, and (*c*) entities that were afforded the scope exceptions of FASB ASC 810, *Consolidation*. We have advised you of all transactions with identified VIEs, potential VIEs, or entities afforded the scope exceptions of FASB ASC 810. We have made available all relevant information about financial interests and contractual arrangements with related parties, de facto agents, and other entities, including but not limited to, their governing documents, equity and debt instruments, contracts, leases, guarantee arrangements, and other financial contracts and arrangements. The information we provided about financial interests and contractual arrangements with related parties, de facto agents, and other entities includes information about all transactions, unwritten understandings, agreement modifications, and written and oral side agreements. Our computations of expected losses and expected residual returns of entities that are VIEs and potential VIEs are based on the best information available and include all reasonably possible outcomes.

(continued)

General

Condition	*Illustrative Examples*
	Regarding entities in which the company has variable interests (implicit and explicit), we have provided all information about events and changes in circumstances that could potentially cause reconsideration about whether the entities are VIEs or whether the company is the primary beneficiary or has a significant variable interest in the entity. We have made and continue to make exhaustive efforts to obtain information about entities in which the company has an implicit or explicit interest, but that were excluded from complete analysis under FASB ASC 810 due to lack of essential information to determine one or more of the following: • Whether the entity is a VIE • Whether the company is the primary beneficiary • The accounting required to consolidate the entity
The work of a specialist has been used by the entity.	We agree with the findings of specialists in evaluating the [*describe assertion*] and have adequately considered the qualifications of the specialist in determining the amounts and disclosures used in the financial statements and underlying accounting records. We did not give or cause any instructions to be given to specialists with respect to the values or amounts derived in an attempt to bias their work, and we are not otherwise aware of any matters that have had an impact on the independence or objectivity of the specialists.

Assets

Condition	*Illustrative Examples*
Cash	
Disclosure is required of compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements.	Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances, lines of credit, or similar arrangements have been properly disclosed.

Assets

Condition	*Illustrative Examples*
Financial Instruments	
Management intends to and has the ability to hold to maturity debt securities classified as held to maturity.	Debt securities that have been classified as held to maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available for sale or trading.
Management considers the decline in value of debt or equity securities to be temporary.	We consider the decline in value of debt or equity securities classified as either available for sale or held to maturity to be temporary.
Management has determined the fair value of significant financial instruments that do not have readily determinable market values.	The methods and significant assumptions used to determine fair values of financial instruments are as follows: [*describe methods and significant assumptions used to determine fair values of financial instruments*]. The methods and significant assumptions used result in a measure of fair value appropriate for financial statement measurement and disclosure purposes.
Financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk exist.	The following information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk has been properly disclosed in the financial statements: 1. The extent, nature, and terms of financial instruments with off-balance-sheet risk 2. The amount of credit risk of financial instruments with off-balance-sheet risk and information about the collateral supporting such financial instruments 3. Significant concentrations of credit risk arising from all financial instruments and information about the collateral supporting such financial instruments
Receivables	
Receivables have been recorded in the financial statements.	Receivables recorded in the financial statements represent valid claims against debtors for sales or other charges arising on or before the balance-sheet date and have been appropriately reduced to their estimated net realizable value.
Inventories	
Excess or obsolete inventories exist.	Provision has been made to reduce excess or obsolete inventories to their estimated net realizable value.

(continued)

Assets

Condition	*Illustrative Examples*
Investments	
Unusual considerations are involved in determining the application of equity accounting.	[*For investments in common stock that are either nonmarketable or of which the entity has a 20 percent or greater ownership interest, select the appropriate representation from the following:*] • The equity method is used to account for the company's investment in the common stock of [*investee*] because the company has the ability to exercise significant influence over the investee's operating and financial policies. • The cost method is used to account for the company's investment in the common stock of [*investee*] because the company does not have the ability to exercise significant influence over the investee's operating and financial policies.
Deferred Charges	
Material expenditures have been deferred.	We believe that all material expenditures that have been deferred to future periods will be recoverable.
Deferred Tax Assets	
A deferred tax asset exists at the balance sheet date.	The valuation allowance has been determined pursuant to the provisions of FASB ASC 740, *Income Taxes*, including the company's estimation of future taxable income, if necessary, and is adequate to reduce the total deferred tax asset to an amount that will more likely than not be realized. [*Complete with appropriate wording detailing how the entity determined the valuation allowance against the deferred tax asset*.] or A valuation allowance against deferred tax assets at the balance sheet date is not considered necessary because it is more likely than not that the deferred tax asset will be fully realized.

Liabilities

Condition	*Illustrative Examples*
Debt	
Short term debt could be refinanced on a long term basis and management intends to do so.	The company has excluded short-term obligations totaling $[*amount*] from current liabilities because it intends to refinance the obligations on a long-term basis. [*Complete with appropriate wording detailing how amounts will be refinanced as follows:*]

Liabilities

Condition	*Illustrative Examples*
	The company has issued a long-term obligation [*debt security*] after the date of the balance sheet but prior to the issuance of the financial statements for the purpose of refinancing the short term obligations on a long term basis. The company has the ability to consummate the refinancing, by using the financing agreement referred to in note [*X*] to the financial statements.
Tax exempt bonds have been issued.	Tax exempt bonds issued have retained their tax-exempt status.
Taxes	
Management intends to reinvest undistributed earnings of a foreign subsidiary.	We intend to reinvest the undistributed earnings of [*name of foreign subsidiary*].
Contingencies	
Estimates and disclosures have been made of environmental remediation liabilities and related loss contingencies.	Provision has been made for any material loss that is probable from environmental remediation liabilities associated with [*name of site*]. We believe that such estimate is reasonable based on available information and that the liabilities and related loss contingencies and the expected outcome of uncertainties have been adequately described in the company's financial statements.
Agreements may exist to repurchase assets previously sold.	Agreements to repurchase assets previously sold have been properly disclosed.
Pension and Postretirement Benefits	
An actuary has been used to measure pension liabilities and costs.	We believe that the actuarial assumptions and methods used to measure pension liabilities and costs for financial accounting purposes are appropriate in the circumstances.
Involvement with a multiemployer plan exists.	We are unable to determine the possibility of a withdrawal liability in a multiemployer benefit plan. or We have determined that there is the possibility of a withdrawal liability in a multiemployer plan in the amount of $[*XX*].

(continued)

Liabilities

Condition	*Illustrative Examples*
Postretirement benefits have been eliminated.	We do not intend to compensate for the elimination of postretirement benefits by granting an increase in pension benefits. or We plan to compensate for the elimination of postretirement benefits by granting an increase in pension benefits in the amount of $[*XX*].
Employee layoffs that would otherwise lead to a curtailment of a benefit plan are intended to be temporary.	Current employee layoffs are intended to be temporary.
Management intends to either continue to make or not make frequent amendments to its pension or other postretirement benefit plans, which may affect the amortization period of prior service cost, or has expressed a substantive commitment to increase benefit obligations.	We plan to continue to make frequent amendments to pension or other postretirement benefit plans, which may affect the amortization period of prior service cost. or We do not plan to make frequent amendments to pension or other postretirement benefit plans.

Equity

Condition	*Illustrative Examples*
Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements exist.	Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements have been properly disclosed.

Income Statement

Condition	*Illustrative Examples*
There may be a loss from sales commitments.	Provisions have been made for losses to be sustained in the fulfillment of or from inability to fulfill any sales commitments.
Nature of the product or industry indicates the possibility of undisclosed sales terms.	We have fully disclosed to you all sales terms, including all rights of return or price adjustments and all warranty provisions.

Dating the Management Representation Letter

5.11 According to paragraph .24 of AR section 90, because the accountant is concerned with events occurring through the date of the report that may require adjustment to, or disclosure in, the financial statements, management's representations set forth in the management representation letter should be made as of the date of the review report. The accountant need not be in physical receipt of the management representation letter as of the date of the review report, provided that management has acknowledged that they will sign the representation letter without modification and it is received prior to the release of the report. However, because written representations are required from management for all financial statements and periods covered by the accountant's review report, the accountant will need to have the signed management representation letter in hand prior to releasing the accountant's review report.

5.12 An illustrative representation letter is presented at the end of this chapter.

Required Elements in Review Reports

5.13 Per paragraph .27 of AR section 90, financial statements reviewed by an accountant should be accompanied by a written report. The accountant's objective in reporting on the financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements. In addition, each page of the financial statements should include a reference such as "See Independent Accountant's Review Report."

Standard Review Report

5.14 The standard review report should identify the financial statements reviewed in the opening (introductory) paragraph, describe management's responsibility for the financial statements in a second paragraph, describe the accountant's responsibility in a third paragraph, and describe the results of the engagement in the fourth (final) paragraph.

5.15 The basic elements of the report are as follows:

a. *Title*. The accountant's review report should have a title that clearly indicates that it is the accountant's review report and includes the word *independent*. An appropriate title would be "Independent Accountant's Review Report."

b. *Addressee*. The accountant's report should be addressed as required by the circumstances of the engagement.

c. *Introductory paragraph*. The introductory paragraph in the accountant's report should

   i. identify the entity whose financial statements have been reviewed;

   ii. state that the financial statements have been reviewed;

   iii. identify the financial statements that have been reviewed;

   iv. specify the date or period covered by the financial statements;

v. include a statement that a review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners); and

vi. include a statement that a review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole, and that, accordingly, the accountant does not express such an opinion.

d. *Management's responsibility for the financial statements*. A statement that management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

e. *Accountant's responsibility*. A statement that the accountant's responsibility is to conduct the review in accordance with SSARSs issued by the AICPA.

A statement that those standards require the accountant to perform the procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements.

A statement that the accountant believes that the results of his or her procedures provide a reasonable basis for his or her report.

f. *Results of engagement*. A statement that, based on his or her review, the accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework, other than those modifications, if any, indicated in the report.

g. *Signature of the accountant*. The manual or printed signature of the accounting firm or the accountant, as appropriate.

h. *Date of the accountant's report*.

Observations and Suggestions

When the accountant is reporting on comparative financial statements and the service performed on the statements is different (for example, the financial statements for the current year are reviewed and the statements for the prior year are compiled), the report title may be generic to the level of service (for example, the report could be titled "Independent Accountant's Report"). Illustrative accountant's reports on comparative financial statements are provided in paragraphs 5.34–.35. Appendix C, "Reporting on Compiled or Reviewed Financial Statements for Periods Ended on or After December 15, 2010, With Comparative Financial Statements for Periods Ended Before December 15, 2010," provides additional guidance on an accountant's reporting requirements when reporting on comparative financial statements and the prior review was not performed in accordance with SSARS No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*).

Observations and Suggestions

The review report should not be dated earlier than the date on which the accountant has accumulated review evidence sufficient to provide a reasonable basis for concluding that the accountant has obtained limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. All required review engagement procedures, including receiving client approval of draft financial statements and draft representations, should be completed in advance of the date of the review report.

Also, keep in mind that Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 855, *Subsequent Events*, requires disclosure by nongovernmental entities of the date through which subsequent events have been evaluated. Because the review report should not be dated earlier than the date on which the accountant has accumulated review evidence sufficient to provide a reasonable basis for concluding that he or she has obtained limited assurance, the review report date can never be earlier than management's subsequent event note date. In most cases, the date that management discloses as the date through which it has evaluated subsequent events (in the notes to the financial statements and in the management representation letter) will be the same date as the accountant's review report. In order to coordinate that these dates (the note date, the representation letter date, and the accountant's review report date) are the same, the accountant may want to discuss these dating requirements with management in advance of beginning the review engagement. The accountant may also want to include, in the accountant's understanding with the client regarding the services to be performed (engagement letter), that management will not date the subsequent event note earlier than the date of management's representations and the date of the accountant's review report.

5.16 Illustrative review reports are included at the end of this chapter.

Departures From the Applicable Financial Reporting Framework

5.17 According to paragraph .34 of AR section 90, an accountant who is engaged to review financial statements may become aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements. If the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure.

5.18 If the accountant concludes that modification of the standard report is appropriate, the departure should be disclosed in a separate paragraph of the report, including disclosure of the effects of the departure on the financial statements if such effects have been determined by management or are known as the result of the accountant's procedures. The accountant is not required to determine the effects of a departure if management has not done so, provided that the accountant states in the report that such determination has not been made.

5.19 Examples of review reports that disclose departures from the applicable financial reporting framework are included at the end of this chapter.

Observations and Suggestions

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

Scope Limitations

5.20 When the accountant is unable to perform the inquiry and analytical procedures he or she considers necessary to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework, the review will be incomplete. A review that is incomplete does not provide an adequate basis for issuing a review report.

Emphasis of a Matter

5.21 Paragraph .33 of AR section 90 states that an accountant may emphasize a matter disclosed in the financial statements. Such explanatory information should be presented in a separate paragraph of the accountant's report. The following guidance is appropriate when the accountant decides to emphasize a matter:

- Emphasis paragraphs should not introduce new information about the financial statements; they should only highlight or emphasize a matter disclosed in the financial statements.
- If the financial statements are deficient or do not contain a needed disclosure and the client does not correct the statements, the accountant is required to state, in a separate paragraph of the report, that the financial statements contain a departure from the applicable financial reporting framework. This required paragraph differs from a voluntary emphasis paragraph.
- Emphasis paragraphs should not contain information about the procedures the accountant has performed or has not performed.
- Emphasis paragraphs should not contain the accountant's conclusions or opinions.
- If the accountant decides to add an emphasis paragraph to highlight a going-concern disclosure in the client's financial statements, the term "substantial doubt" should not be used in that paragraph. ("Substantial doubt" is an audit evidence-based concept that should only be used in audit reports.)

5.22 When the accountant decides to emphasize a matter, the matter should be described in a separate paragraph added to the standard report. An example of this report is included at the end of this chapter.

Reporting on Supplementary Information

5.23 When the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility taken, if any, he or she is taking with respect to such information. When the accountant has reviewed the basic financial statements, he or she should include an explanation either in the review report on the basic financial statements or in a separate report on the other data. Specifically, the explanation should state that the review was made primarily for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with the applicable financial reporting framework. The explanation should also state that either

- the other data accompanying the financial statements are presented only for supplementary analysis purposes and have been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements and the accountant did not become aware of any material modifications that should be made to such data, or
- the other data accompanying the financial statements are presented only for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the financial statements but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data (in other words, the accountant is stating that he or she reviewed the financial statements but only compiled the supplementary information).

5.24 In any case, the important thing to remember is that the accountant should clearly indicate the degree of responsibility he or she is taking for any information accompanying the basic financial statements.

5.25 Examples of these reporting alternatives are presented at the end of this chapter.

Reporting on Personal Financial Statements

5.26 Personal financial statements reviewed by an accountant should be accompanied by a written report. The accountant's objective in reporting on personal financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements. Paragraph .28 of AR section 90 outlines the basic elements of an accountant's review report.

5.27 An illustration of an accountant's standard review report on reviewed personal financial statements is included in the exhibit, "Compilations and Reviews of Personal Financial Statements," at the end of this guide.

Exhibit 5-1

Comparison of Review Reporting Requirements for Reviews of Financial Statements for Periods Ending Prior to December 15, 2010, and Reviews of Financial Statements for Periods Ending on or After December 15, 2010

	Review Report on Financial Statements for Periods Ending Prior to December 15, 2010	*Review Report on Financial Statements for Periods Ending on or After December 15, 2010*
Title	Not required	Independent Accountant's Review Report
Addressee	Not required	[*Appropriate Salutation*]
Introductory paragraph In the report on financial statements for periods ending on or after December 15, 2010, the scope of the engagement is described (it was included in the second paragraph of the previous review report). Management's responsibilities are moved to a separate paragraph.	I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of management (owners) of XYZ Company.	I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.
Second paragraph The report on financial statements for periods ending on or after December 15, 2010, describes management's responsibilities. The scope of the	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	Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and

	Review Report on Financial Statements for Periods Ending Prior to December 15, 2010	*Review Report on Financial Statements for Periods Ending on or After December 15, 2010*
engagement is included in the introductory paragraph	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.	maintaining internal control relevant to the preparation and fair presentation of the financial statements.
Paragraph describing the accountant's responsibilities		My (our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.
Paragraph describing the results of the engagement	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 accounting principles generally accepted in the United States of America.	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 accounting principles generally accepted in the United States of America.

Communicating to Management and Others

5.28 During the performance of review procedures, evidence or information may come to the accountant's attention that indicates that fraud or an illegal act may have occurred. If that happens, the matter should be brought to the attention of the appropriate level of management. However, the accountant does not need to report matters regarding illegal acts that are clearly inconsequential.

Observations and Suggestions

The accountant may reach agreement in advance with the client on the nature of illegal acts to be communicated and may choose to include this in the engagement letter. An important distinction between the communication requirements of fraud and illegal acts relates to the fact that the accountant should communicate all instances of fraud to the appropriate level of management and, if applicable, those charged with governance. Essentially, although there might be a threshold below which certain illegal acts do not need to be communicated, no parallel threshold exists related to communicating instances of fraud to the client.

If the fraud or illegal acts involve senior management, the accountant should report the matter to an individual or group at a higher level within the entity, such as the manager (owner) or those charged with governance. This communication may be oral or written. However, if the communication is oral, the accountant should document it.

Unless an illegal act is determined to be clearly inconsequential, the accountant also should consider consulting with his or her legal counsel whenever any evidence or information comes to the accountant's attention that fraud or an illegal act may have occurred. When matters regarding fraud or an illegal act involve an owner of the business, the accountant should consider resigning from the engagement.

5.29 The disclosure of any evidence or information that comes to the accountant's attention related to fraud or an illegal act to parties other than the client's senior management or, when applicable, those charged with governance, ordinarily is not part of the accountant's responsibility. In addition, the accountant generally would be precluded from disclosing this information by his or her ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances, a duty to disclose to parties outside the client may exist:

a. To comply with certain legal and regulatory requirements

b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with AR section 400, *Communications Between Predecessor and Successor Accountants* (AICPA, *Professional Standards*), regarding acceptance of an engagement to compile or review the financial statements of a nonissuer

c. In response to a subpoena

5.30 Potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex. Therefore, if one of these circumstances arises, the accountant may wish to consult with legal counsel before discussing matters related to fraud and illegal acts with parties outside the client.

Observations and Suggestions

Although the predecessor accountant would have a duty to disclose matters involving fraud or illegal acts to a successor accountant when the successor decides to communicate with the predecessor, in accordance with AR section 400, regarding acceptance of an engagement to compile or review financial statements of a nonissuer, the successor is required to request permission from the prospective client to make any inquiries of the predecessor.

5.31

Illustrative Engagement Letter

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the financial statements of XYZ Company as of December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a review is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for:

a. The preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*]

b. Designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements

c. Preventing and detecting fraud

d. Identifying and ensuring that the entity complies with the laws and regulations applicable to its activities

e. Making all financial records and related information available to us

f. Providing us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A review includes primarily applying analytical procedures to your financial data and making inquiries of company management. A review is substantially less in scope that an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion regarding the financial statements as a whole.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform the appropriate level of management of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

XYZ Company

____

President

____

Date

5.32

Illustrative Management Representation Letter

The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of the review engagement or the industry in which the entity operates, that other matters should be specifically included in the letter or that some of the representations included in the illustrative letter are not necessary.

[*Date*]

To [*the Accountant*]

We are providing this letter in connection with your review of the [*identification of financial statements*] of [*name of entity*] as of [*dates (for example, December 31, 20X1, and December 31, 20X2)*] and for the [*periods of review (for example, for the years then ended)*] for the purpose of obtaining limited assurance that that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*]. We confirm that we are responsible for the fair presentation of the financial statements in accordance with [*the applicable financial reporting framework*] and the selection and application of the accounting policies.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person using the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, (as of [*the date of the accountant's review report*]) the following representations made to you during your review.

1. The financial statements referred to previously are fairly presented in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].
2. We have made the following available to you:
    a. Financial records and related data.
    b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. No material transactions exist that have not been properly recorded in the accounting records underlying the financial statements.
4. We acknowledge our responsibility for the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].
5. We acknowledge our responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

6. We acknowledge our responsibility to prevent and detect fraud.
7. We have no knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others.
8. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
9. No material losses exist (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
10. None of the following exist:
    a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency
    b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*.
    c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450.
11. The company has satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
12. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
13. The following have been properly recorded or disclosed in the financial statements:
    a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
    b. Guarantees, whether written or oral, under which the company is contingently liable.
    c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with FASB ASC 275, *Risks and Uncertainties*. [*Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.*]

[*Add additional representations that are unique to the entity's business or industry*.]

We are in agreement with the adjusting journal entries you have recommended, and they have been posted to the company's accounts (if applicable).

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.

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

____

[*Name of Owner or Chief Executive Officer and Title*]

____

[*Name of Chief Financial Officer and Title, when applicable*]

5.33

Illustrative Review Reports

Financial Statements Prepared in Accordance With Accounting Principles Generally Accepted in the United States of America (U.S. GAAP)

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements of a Not-for-Profit Entity Prepared in Accordance With U.S. GAAP

Independent Accountant's Review Report

Board of Trustees

ABC Organization

I (We) have reviewed the accompanying statement of financial position of ABC Organization (a not-for-profit entity) as of June 30, 20XX, and the related statement of activities and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of organization management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements of a Governmental Entity Prepared in Accordance With U.S. GAAP

Independent Accountant's Review Report

Honorable Mayor, Members of the City Council, and Citizens of City of X

City of X, State Y

I (We) have reviewed the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of City of X, State Y, as of and for the year ended June 30, 20XX, which collectively comprise the City's basic financial statements as listed in the table of contents. A review includes primarily applying analytical procedures to management's financial data and making inquiries of the management of City of X, State Y. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

The management of the City of X, State Y, is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

My (Our) review was made primarily for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. The management's discussion and analysis and budgetary comparison information on pages X through X and XX through XX, are presented for purposes of additional analysis. Such information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board which considers it to be an essential part of financial reporting and for placing the basic financial statements in an appropriate operational, economic, or historical context. The supplementary information has not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but it has been compiled from information that is the representation of management. I (We) have not audited or reviewed the supplementary information and accordingly, I (we) do not express an opinion or provide any assurance on such supplementary information.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With the Income Tax Basis of Accounting

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying statement of assets, liabilities, and equity—income tax basis of XYZ Company as of December 31, 20XX, and the related statement of revenue and expenses—income tax basis for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with the income tax basis for accounting and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provides a reasonable basis for my (our) report.

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.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With International Financial Reporting Standards (IFRSs) as Issued by the International Accounting Standards Board (IASB) Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) reviews, 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 International Financial Reporting Standards as issued by the International Accounting Standards Board.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country—Intended for Use in the United States of America

<u>Independent Accountant's Review Report</u>

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with [*the financial reporting framework generally accepted in another country, including identification of the nationality of the framework*] and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) reviews, 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 financial reporting framework generally accepted in another country, including identification of the nationality of the framework*].

This report is intended solely for the information and the use of [*specified parties*] and is not intended to be and should not be used by anyone other than the specified parties.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With IFRSs as Issued by the IASB—Engagement Performed in Accordance With SSARSs and in Accordance With International Standard on Review Engagements 2400, *Engagements to Review Financial Statements*

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with International

Financial Reporting Standards as issued by the International Accounting Standards Board and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants and in accordance with International Standard on Review Engagements (ISRE 2400) issued by the International Audit and Assurance Standards Board. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) reviews, 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 or International Financial Reporting Standards as issued by the International Accounting Standards Board.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Departure From U.S. GAAP

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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

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

or

As disclosed in note X to the financial statements, the company has adopted [*description of newly adopted method*], whereas it previously used [*description of previous method*]. Although the [*description of newly adopted method*] is in conformity with accounting principles as generally accepted in the United States of America, the company does not appear to have reasonable justification for making a change as required by Financial Accounting Standards Board *Accounting Standards Codification* 250, *Accounting Changes and Error Corrections*.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP With Emphasis of a Matter

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

As discussed in note X, XYZ Company is a defendant in litigation concerning personal injuries alleged to have occurred to a customer while on XYZ Company's premises. The amount of damages to be paid to the plaintiff, if any, cannot currently be determined. Accordingly, no provision for the legal claim has been made in the accompanying financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP Accompanied by Supplementary Information Reviewed by the Accountant

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

My (Our) review was made primarily for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. The supplementary information appearing on pages XX through XX is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, and I (we) did not become aware of any material modifications that should be made to such information.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Financial Statements Prepared in Accordance With U.S. GAAP Accompanied by Supplementary Information Compiled by the Accountant

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

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 accounting principles generally accepted in the United States of America.

My (Our) review was made primarily for the purpose of expressing a conclusion that there are no material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. The supplementary information included on pages XX through XX is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements but has been compiled from information that is the representation of management. I (We) have not audited or reviewed the supplementary information, and accordingly, I (we) do not express an opinion or provide any assurance on such supplementary information.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

5.34

Illustrative Accountant's Review Reports on Comparative Financial Statements—Continuing Accountant

Independent Accountant's Review Report on Comparative Financial Statements When a Review Has Been Performed for Both Periods

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) reviews, 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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Review Report on Comparative Financial Statements When the Accountant's Report Includes a Changed Reference to a Departure From U.S. GAAP

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

In my (our) report dated March 1, 20X2, with respect to the 20X1 financial statements, I (we) referred to a departure from accounting principles generally accepted in the United States of America because the company carried its land at appraised values. As described in note X, the Company has changed its method of accounting for land and restated its 20X1 financial statements to conform with accounting principles generally accepted in the United States of America. Accordingly, my (our) present statement on the 20X1 financial statements, as presented herein, that I am (we are) not aware of any material modifications that should be made to the accompanying financial statements is different from that expressed in my (our) previous report.

Based on my (our) reviews, 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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Review Report on Comparative Financial Statements When the Accountant's Report on the Prior-Period Financial Statements Is Corrected

<u>Independent Accountant's Review Report</u>

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 20X2 and 20X1, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on our reviews, with the exception of the matter described in the following paragraphs, 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 accounting principles generally accepted in the United States of America.

In my (our) report dated [*insert date*], I (we) expressed that based on my (our) procedures, I was (we were) not aware of any material modifications that should be made to the 20X1 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America. During the review of the 20X2 financial statements, I (we) became aware that the 20X1 financial statements contained a departure from accounting principles generally accepted in the United States of America. As disclosed in note X to the financial statements, accounting principles generally accepted in the United States of America require investments in marketable equity securities to be reported at fair value. Management of XYZ Company has informed me (us) that these investments were stated at cost in the 20X1 financial statements and that, if accounting principles generally accepted in the United States of America had been followed, the investment in marketable equity securities and stockholders' equity as of December 31, 20X1, would have been decreased by $[*amount*]. As of December 31, 20X2, all investments in marketable equity securities were stated at fair value in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Report on Comparative Financial Statements When the Financial Statements of the Current Period Have Been Reviewed and Those of the Prior Period Have Been Compiled

<u>Independent Accountant's Report</u>

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The accompanying 20X1 financial statements of XYZ Company were compiled by me (us). The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. Accordingly, I (we) do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Report on Comparative Financial Statements When the Financial Statements of the Current Period Have Been Reviewed and Those of the Prior Period Have Been Compiled and a Departure Is Discovered in the Prior-Period Financial Statements

<u>Independent Accountant's Report</u>

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The accompanying 20X1 financial statements of XYZ Company were compiled by me (us). The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements. Accordingly, I (we) do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

During the review of the 20X2 financial statements, I (we) became aware that the 20X1 financial statements contained a departure from accounting principles generally accepted in the United States of America. I (We) were not aware of the departure from accounting principles generally accepted in the United States of America at the conclusion of our compilation of the 20X1 financial statements and, accordingly did not refer to the departure in my (our) report dated [*insert date*] on the 20X1 financial statements. As disclosed in note X to the financial statements, investments in marketable equity securities should have been reported at fair value in the financial statements rather than at cost. If accounting principles generally accepted in the United States of America had been followed, the investments in marketable equity securities and stockholders' equity as of December 31, 20X1, would have been decreased by $[*amount*]. However, XYZ Company has restated its 20X1 financial statements to reflect the valuation of its investments in marketable equity securities at fair value in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Audited

<u>Independent Accountant's Report</u>

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The 20X1 financial statements were audited by me (us) and I (we) expressed an unqualified opinion on them in my (our) report dated March 1, 20X2, but I (we) have not performed any auditing procedures since that date.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

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Illustrative Accountant's Review Reports on Comparative Financial Statements—Noncontinuing Accountant

Independent Accountant's Review Report on Comparative Financial Statements When the Prior-Period Financial Statements Were Reviewed by a Predecessor Accountant, and the Predecessor's Report Is Not Presented

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. The financial statements of XYZ Company as of December 31, 20X1, were reviewed by other accountants whose report dated February 1, 20X2, stated that based on their procedures, they are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant’s Review Report on Comparative Financial Statements When The Prior Period Financial Statements Were Compiled by a Predecessor Accountant, and the Predecessor’s Report Is Not Presented

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. The financial statements of XYZ Company as of December 31, 20X1, were compiled by other accountants whose report dated February 1, 20X2, stated that they have not audited or reviewed the 20X1 financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Review Report on Comparative Financial Statements When the Prior Period Financial Statements Were Audited by a Predecessor Auditor, and the Predecessor's Report Is Not Presented

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

The 20X1 financial statements were audited by other accountants and they expressed an unqualified opinion on them in their report dated March 1, 20X2, but they have not performed any auditing procedures since that date.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Independent Accountant's Review Report on Comparative Financial Statements When the Predecessor Accountant's Report Is Not Presented, and the Successor Accountant Is Engaged to Review the Restatement Adjustments

Independent Accountant's Review Report

Board of Directors

XYZ Company

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion. The financial statements of XYZ Company as of December 31, 20X1, prior to adjustment were reviewed by other accountants whose report dated February 1, 20X2, stated that based on their procedures, they are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 20X2 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

I (We) also reviewed the adjustments described in note X that were applied to restate the 20X1 financial statements. Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the adjustments described in note X that were applied to restate the 20X1 financial statements in order for them to be in conformity with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Appendix A

Understanding Internal Control and Internal Control Services

by Thomas A. Ratcliffe, CPA, and Charles E. Landes, CPA

Over the past several years, practitioners in public practice have expressed confusion relating to the concept of internal control and, specifically, internal control over financial reporting.

For example, auditors may no longer default to a maximum control risk. Instead,

> the auditor should obtain an understanding of the five components of internal control sufficient to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. The auditor should obtain a sufficient understanding by performing risk assessment procedures to evaluate the design of controls relevant to an audit of financial statements and to determine whether they have been implemented.[1]

This created a need for auditors to understand the concepts of internal control and, specifically, internal control over financial reporting.

Additionally, internal control deficiencies identified by an auditor that upon evaluation are considered significant deficiencies or material weaknesses should be communicated in writing to management and those charged with governance.[2] This standard also has led to a great deal of discussion about what is or is not a control and what role an auditor can play, with respect to the client's system of internal control.

Even if a practitioner in public practice does not perform audits but performs reviews and compilations, that practitioner must still understand internal control, due to the independence ramifications, because a practitioner's independence would be impaired if he or she establishes or maintains internal control for a client.[3]

This appendix describes the concepts of internal control (specifically internal control over financial reporting) and discusses the types of services related to internal control that may be performed by practitioners in public practice.

What Is Internal Control?

Small business owners and management have long sought ways to better control the organization they manage. A system of internal control is put in place to keep the organization on course toward profitability goals and achievement of its mission and to minimize surprises along the way. An effective system of internal control enables management to deal with rapidly changing economic

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[1] Paragraph .40 of AU section 314, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement* (AICPA, *Professional Standards*).

[2] AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*).

[3] Interpretation No. 101-3, "Performance of nonattest services," under Rule 101, *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .05).

and competitive environments, shifting customer demands and priorities, and restructuring for future growth. Internal control promotes efficiency, reduces risks of asset loss, and helps ensure the reliability of financial statements and compliance with laws and regulations.

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) published a report titled *Internal Control—Integrated Framework* (the framework).[4] This document provides principles-based guidance for designing and implementing[5] effective internal control. COSO developed the framework in response to senior executives' needs for effective ways to better control their enterprises and to help ensure that organizational objectives related to operations, reporting, and compliance are achieved. This framework has become the most widely used internal control framework in the United States and has been adapted or adopted by numerous countries and businesses around the world.

The framework defines *internal control* as follows:

> Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
>
> - Effectiveness and efficiency of operations
> - Reliability of financial reporting
> - Compliance with applicable laws and regulations

This definition reflects certain fundamental concepts:

- Internal control is a process. It's a means to an end, not an end in itself.
- Internal control is affected by people. It's not merely policy manuals and forms but people at every level of an organization.
- Internal control can be expected to provide only reasonable assurance, not absolute assurance, to an entity's management and board.
- Internal control is geared to the achievement of objectives in one or more separate but overlapping categories.

Management Objectives

Internal control includes techniques used by management to achieve its objectives and meet its responsibilities in three distinct categories:

- Effectiveness and efficiency of operations
- Reliability of financial reporting
- Compliance with applicable laws and regulations

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[4] In addition to its original framework, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) has subsequently issued *Internal Control over Financial Reporting—Guidance for Smaller Public Companies.* This document neither replaces nor modifies the original framework but rather provides guidance on how to apply it. Although it is directed at smaller public companies, its guidance also can be used by nonpublic entities, including not-for-profit entities.

[5] For purposes of this appendix, the phrase *design and implement*, as used by COSO, is assumed to mean the same as *establish and maintain*.

The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources. The second relates to the preparation of reliable published financial statements. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

Internal Control Over Financial Reporting

The term *reliability*, as used with financial reporting objectives, involves the preparation of financial statements that are fairly presented in conformity with the applicable financial reporting framework used by management.[6] Therefore, a system of internal control over financial reporting includes the design and implementation of those policies and procedures deemed necessary by management to provide reasonable assurance that the entity's financial statements are fairly presented in accordance with the basis of accounting chosen by management. Controls are those specific policies and procedures designed and implemented to prevent or detect and correct misstatements that, if not prevented or corrected, would cause the financial statements to not be fairly presented.

Fair presentation is defined as follows:

- The accounting principles selected and applied have general acceptance.
- The accounting principles are appropriate in the circumstances.
- The financial statements are informative of matters that may affect their use, understanding, and interpretation.
- The information presented is classified and summarized in a reasonable manner (that is, it is neither too detailed nor too condensed).
- The financial statements reflect the underlying transactions and events in a manner that presents the financial position, results of operations, and cash flows within a range of acceptable limits (that is, limits that are reasonable and practical to attain in financial statements).

Also inherent in fair presentation is the concept of materiality.

Supporting these objectives is a series of assertions that underlie an entity's financial statements. *Assertions* are management's implicit or explicit representations regarding the recognition, measurement, presentation, and disclosure of information in the financial statements and related disclosures. Assertions fall into three categories: (1) classes of transactions, (2) account balances, and (3) presentation and disclosure. Financial statement assertions include the following:

- *Existence or occurrence.* Assets, liabilities, and ownership interests exist at a specific date, and recorded transactions represent events that actually occurred during a certain period.
- *Completeness.* All transactions and other events and circumstances that occurred during a specific period and that should have been recognized in that period have, in fact, been recorded.

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[6] Applicable reporting frameworks include not only generally accepted accounting principles but also an other comprehensive basis of accounting frameworks.

- *Rights and obligations.* Assets are the rights and liabilities are the obligations of the entity at a given date.
- *Accuracy, valuation, or allocation.* Asset, liability, revenue, and expense components are recorded at appropriate amounts in conformity with relevant and appropriate accounting principles. Transactions are mathematically correct and appropriately summarized and recorded in the entity's books and records.
- *Cut off.* Transactions and events have been recorded in the correct accounting period.
- *Classification and understandability.* Items in the statements have been properly described, sorted, and classified. Financial information is appropriately presented and described, and information in disclosures is expressed clearly.

How does a small business owner know that all of the assets and liabilities presented in the financial statements actually exist? What can management and small business owners do to ensure that financial statements are complete? How does management know that certain complex accounting transactions are recorded properly? How can proper allocation among accounts and between periods be assured? How does management know what disclosures are necessary in accordance with various accounting frameworks? Only well-designed, properly implemented, and adequately maintained control-related policies and procedures can provide management with a reasonable basis for making the implicit assertions that underlie any financial statement.

However, many small businesses[7] and nonprofit and governmental organizations do not have the internal accounting expertise necessary to prepare reliable financial statements. Accordingly, practitioners in public practice have played an important role, through the performance of a variety of services, in helping those clients with their accounting systems and in the preparation of appropriate financial statements. Because of the complexity of many accounting standards, the practitioner's involvement in the client's system of internal control over financial reporting improves the quality and reliability of the financial information and results in more informed decision making by financial statement users. Those users, including third-party users, as well as management, those charged with governance, and owners of small businesses, count on the practitioner to help management "get it right." In other words, the practitioner assists the client in preventing or detecting and correcting misstatements in the financial statements or management's financial information.

Components of Internal Control

Internal control consists of five interrelated components. These are derived from the way management runs an organization and are integrated with the management process. Although the components apply to all entities, smaller organizations may implement them differently than larger ones. Their controls may be less formal and less structured, yet a small organization can still have effective internal control. The five components of internal control are described in the following sections.

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[7] In some cases, this includes smaller public companies.

Control Environment

The control environment component is the foundation upon which all other components of internal control are based, and it sets the tone of an organization. A small business can have unique advantages in establishing a strong control environment. Employees in many smaller businesses interact more closely with top management and are directly influenced by management actions. Through day-to-day practices and actions, management can effectively reinforce the company's fundamental values and directives. The close working relationship also enables senior management to quickly recognize when employees' actions need modification.

Risk Assessment

Risk assessment, as it relates to the objective of reliable financial reporting, involves identification and analysis of the risks of material misstatement. Establishment of financial reporting objectives articulated by a set of financial statement assertions for significant accounts is a precondition to the risk assessment process. Risk assessment in small businesses can be relatively efficient, often because in-depth knowledge of the company's operations enables the owner and management to have first-hand information of where risks exist. In carrying out their normal responsibilities, including obtaining information gained from employees, customers, suppliers, and others, these managers identify risks inherent in business processes. In addition to focusing on operations and compliance risks, they are positioned to consider the following risks to reliable financial reporting:

- Failing to capture and record all transactions
- Recording assets that do not exist or transactions that did not occur
- Recording transactions in the wrong period or wrong amount or misclassifying transactions
- Losing or altering transactions once recorded
- Failing to gather pertinent information to make reliable estimates
- Recording inappropriate journal entries
- Improperly accounting for transactions or estimates
- Inappropriately applying formulas or calculations

Control Activities

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties. When resource constraints compromise the ability to segregate duties, many smaller companies use certain compensating controls to achieve the objectives.

Information and Communication

Information systems identify, capture, process, and distribute information supporting the achievement of financial reporting objectives. Information systems in small businesses are likely to be less formal than in large ones, but their role is just as significant. Many small businesses rely more on manual or stand-alone IT applications than complex integrated applications. Effective internal communication between top management and employees may be facilitated in smaller companies due to fewer levels and numbers of personnel and greater visibility and availability of the owner. Internal communication can take place through frequent meetings and day-to-day activities in which the owner and other managers participate.

Monitoring

Internal control systems need to be monitored, which is a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Managers of many smaller businesses have high-level first-hand knowledge of company activities, and their close involvement in operations positions them to identify variances from expectations and potential inaccuracies in reported financial information.

COSO has depicted how these elements work together from a process perspective as follows:

What Are Nonattest Services?

According to the AICPA Code of Professional Conduct (code), the term *nonattest services* includes accounting, tax, and consulting services that are not part of an attest engagement. Attest engagements include financial statement audits, reviews, and compilations, as well as any engagement performed under the Statements on Standards for Attestation Engagements (for example, agreed-upon procedures engagements). Therefore, nonattest services include all services that are not attest services. Pursuant to the code, the performance of certain general activities would impair independence. One general activity is establishing or maintaining internal controls, including performing ongoing monitoring activities for a client.[8,9]

What Are Internal Control Services?

Internal control services are nonattest services performed by an accountant to design or operate an aspect of management's system of internal control over financial reporting. A system of internal control over financial reporting includes those policies and procedures designed and operated to prevent, or detect and correct, misstatements in the entity's financial statements. Procedures performed as part of an internal control service have a different intent from procedures performed as part of an attest service. When performing internal control services, such procedures are performed for the benefit of management, and the results of those procedures are used by management. On the other hand, attestation procedures are performed for the benefit of the practitioner in helping him or her form the basis for his or her report.[10]

Internal control services may include establishing the control (designing a control to prevent, or detect and correct, a misstatement) or maintaining the control (performing or operating the control to prevent, or detect and correct, a misstatement), or both. Internal control services may be performed for public companies (performing monitoring procedures for the benefit of management to provide an assertion under Rule 404[a] of the Sarbanes-Oxley Act of 2002), or they may be performed for private entities. Internal control services that prevent, or detect and correct, misstatements in the financial statements traditionally are categorized as described in the following sections.

Point of Emphasis

The examples of internal control services in the following sections are not intended to be all-inclusive. The key point is that if the nonattest service establishes or maintains internal control, then that service is an internal control service, and establishing or maintaining internal controls for a client will impair independence.

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[8] See Interpretation No. 101-3.

[9] In February 2011 the Professional Ethics Executive Committee issued the exposure draft *Omnibus Proposal: AICPA Professional Ethics Division Interpretations and Rulings*. The exposure draft includes proposed revisions to Interpretation No. 101-3. Among other revisions, the proposal would change the section of Interpretation No. 101-3 that lists general activities that impair a CPA's independence to a list of examples of activities that would be considered management's responsibility and, therefore, impair a CPA's independence when performed for an attest client. The following marked text shows the proposed change relative to internal control (new language is shown in boldface italics, deleted language is shown by strikethrough):

> ***Accepting responsibility for designing, implementing,*** ~~Establishing~~ or maintaining internal controls~~, including performing ongoing monitoring activities~~ for a client.
>
> The proposed revision clarifies that, if management accepts responsibility for the results of the accountant's services, and the accountant meets the other general requirements of Interpretation No. 101-3, the accountant's independence would not be impaired. CPAs should refer to Interpretation No. 101-3 for the general requirements for determining whether any specific nonattest service impairs independence.

[10] Attestation services may indirectly benefit management. For example, if a practitioner identifies a misstatement in the financial statements while performing a review engagement and proposes an adjustment to correct a material misstatement, management is benefited. However, the direct purpose of the review procedure was performed for the benefit of the practitioner in obtaining review evidence.

Approval, Authorization, and Verification

The first step toward controlling financial reporting is to ensure that all transactions are properly authorized in accordance with management's policies. Management authorizes employees to perform certain activities and execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.

Authorization is the delegation of authority, and it may be general or specific. Giving a department permission to expend funds from an approved budget is an example of general authorization. Specific authorization relates to individual transactions; it requires the signature or electronic approval of a transaction by a person with approval authority. Approval of a transaction means that the approver has reviewed the supporting documentation and is satisfied that the transaction is appropriate; accurate; and complies with applicable laws, regulations, policies, and procedures. Generally, approvers review supporting documentation, question unusual items, and make sure that necessary information is present to justify the transaction before they sign off on the transaction.

As a general rule, authorization controls do both of the following:

- Require advance approval
- Require written documentation of approval

Example of Internal Control Service

The practitioner may perform procedures that entail approval, authorization, or verification. These procedures are performed for the benefit of management to prevent misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish authorization control	The practitioner designs a control that establishes approval limits and states that approvers should review supporting documentation, question unusual items, and make sure that necessary information is present to justify the transaction before signing a check.
Maintain authorization control	The practitioner maintains the control of reviewing and approving transaction classifications prior to posting the transaction in the general ledger.

Security of Assets and Records

Security must be maintained over an entity's assets to minimize the danger of loss or misuse. What is frequently overlooked, however, is that security over an entity's accounting records is equally important. It does little good, for instance, to maintain tight control over assets if easy access to the underlying accounting records subjects those assets to substantial potential loss. Adequate security over assets and records generally encompasses all of the following:

- Controlled access
- Physical security
- Backup for computer records
- Disaster recovery

Example of Internal Control Service

The practitioner may perform procedures that relate to the security of assets and records. These procedures are performed for the benefit of management, primarily to prevent and detect misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish security control	The practitioner designs controls that require that access to equipment, inventories, securities, cash, and other assets is restricted through the use of locks, passwords, and data encryption.
Maintain security control	The practitioner performs a control that requires periodically counting inventory items and comparing those counts to balances per the perpetual records.

Segregation of Duties

Segregation of duties is critical to effective internal control because it reduces the risks of both erroneous and inappropriate actions. An incompatible duty is one that would put a single individual in the position of being able to commit an irregularity and then conceal it. For instance, receiving reports are used to ensure that ordered goods have actually been received before payment is made. If a single individual was able to place orders and prepare receiving reports, that person could then fabricate fictitious orders, resulting in improper payments. Accordingly, such incompatible duties should be segregated.

In practice, three types of functions are considered to be mutually incompatible: authorization, record keeping, and custody. Thus, no single individual should be able to (1) authorize a transaction, (2) record the transaction in the accounting records, and (3) maintain custody of the assets resulting from the transaction. When these functions cannot be separated, due to limited personnel, a detailed supervisory review of related activities may be used as a compensating control activity.

Example of Internal Control Service

The practitioner may perform procedures that relate to segregation of duties. These procedures are performed for the benefit of management, primarily to prevent misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish segregation of duties control	While performing monitoring procedures, the practitioner determines that the person who opens the mail and prepares a listing of the checks received is the same person who makes the deposit. The practitioner then establishes a new control for implementation.
Maintain segregation of duties control	The practitioner performs cash reconciliations in order to segregate that duty from the person who has custody of the checks.

Periodic Reconciliations

Broadly defined, *reconciliation* is a comparison of different sets of data to one another, identifying and investigating differences and taking corrective action, when necessary, to resolve differences. Reconciling balances reported in general ledger control accounts to related amounts reported in subsidiary ledger accounts is an example of reconciling one set of data to another. This control activity helps ensure the accuracy and completeness of transactions. To ensure proper segregation of duties, the person who approves transactions or handles cash receipts should not be the person who performs the reconciliation. A critical element of the reconciliation process is to resolve differences. It does no good to note differences and do nothing about them. Differences should be identified, investigated, and explained—corrective action must be taken. Reconciliations should be documented and approved by management.

Example of Internal Control Service

The practitioner may perform procedures that relate to periodic reconciliations. These procedures are performed for the benefit of management, primarily to detect misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish reconciliation control	The practitioner establishes the control policy that requires comparison of vacation and sick leave balances per departmental records to vacation and sick leave balances per the payroll system.
Maintain reconciliation control	The practitioner maintains a control that reconciles the detail of fixed assets per the fixed asset ledger to the general ledger accounts. Any differences noted by the practitioner are investigated and adjusted as necessary.

Analytical Review

Reviewing reports, statements, reconciliations, and other information by management is an important control activity; management should review such information for consistency and reasonableness. Reviews of performance provide a basis for detecting problems. Management should compare information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow up. Management's review of reports, statements, reconciliations, and other information should be documented, as well as the resolution of items noted for follow up. Analytical review also is often the most efficient means to ensure adequate control in situations when it is not practical to segregate incompatible duties.

Point of Emphasis

Analytical procedures performed as part of a review or audit engagement are not considered internal control services. Analytical review procedures performed as part of an internal control service have a different intent from analytical procedures performed as part of a review or audit. When performing internal control services, the analytical procedures are performed for the direct benefit of management, and the results of those procedures are used by management. Analytical procedures performed as part of a review or audit engagement are for the direct purpose of gathering evidence for the benefit of the practitioner in helping him or her form the basis for his or her report.

Example of Internal Control Service

The practitioner may perform procedures that relate to analytical review. These procedures are performed for the benefit of management, primarily to detect misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish analytical review control	The practitioner designs a control that compares information about current performance to budgets, forecasts, prior periods, or other benchmarks on a monthly basis to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow up.
Maintain analytical review control	The practitioner performs a monthly analytical review by comparing internal financial information with other financial or nonfinancial data to identify unexpected results and follows up to determine the cause of the unexpected results.

Controls Over Information Systems

Controls over information systems are grouped into two broad categories: general and application controls. General controls commonly include controls over software acquisition and maintenance, access security, and application system development and maintenance. Application controls, such as computer matching and edit checks, are programmed steps within application software. They are designed to help ensure the completeness and accuracy of transaction processing, authorization, and validity. General controls are needed to support the functioning of application controls; both are needed to ensure complete and accurate information processing.

Example of Internal Control Service

The practitioner may perform procedures that relate to controls over information systems. These procedures are performed for the benefit of management, primarily to prevent and detect misstatements in the financial statements. The following examples illustrate how this internal control service may be performed for a client:

Establish information system control	The practitioner designs a disaster recovery plan that includes specific file backup policies and procedures.
Maintain information system control	The practitioner performs a periodic backup of accounting system and data files.

Summary

Nonattest services consist of all services performed for a client, other than attest services. Therefore, any service performed for a client outside of an audit, review, compilation, or other attest service is a nonattest service. Any service that establishes or maintains internal controls, including monitoring for the client, is a nonattest service, and it impairs independence. These services are referred to as *internal control services*. Internal control services are performed for the benefit of management, and the results of those procedures are used by management to help prevent or detect and correct misstatements in the financial statements. The subsequent figure illustrates the relationship of internal control services to nonattest services.

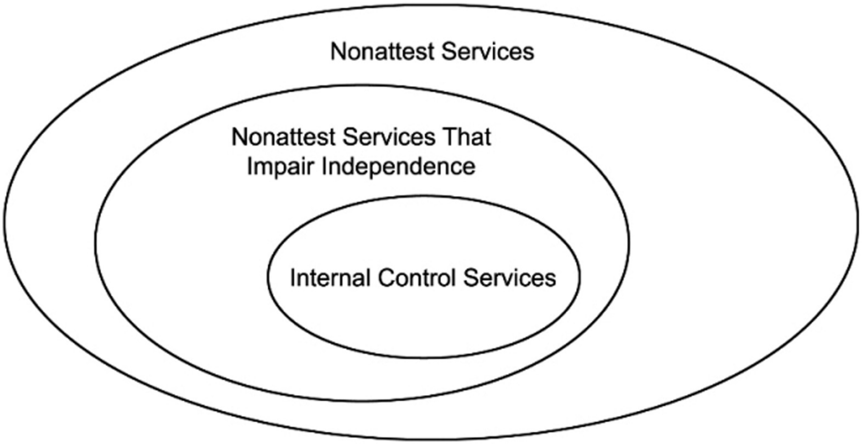
The practitioner may perform a variety of internal control services for a client, including the following:

- *Related to the control environment.* These services may include establishing job descriptions and responsibilities, implementing complex accounting standards, and evaluating the competency of personnel.
- *Related to risk assessment.* These services may include indentifying financial statement assertions, reviewing financial accounting policies, and evaluating financial reporting processes.
- *Related to control activities.* These services may include selecting and developing specific policies and procedures, such as segregation of incompatible duties and compensating controls.

- *Related to information and communication.* These services may include communicating information regarding financial reporting objectives to those charged with governance, such as the board of directors, and consulting with outside advisors on behalf of management.
- *Related to monitoring.* These services may include identifying and correcting internal control deficiencies on behalf of the owner and management.

Point of Emphasis

Monitoring can be accomplished through ongoing activities, separate evaluations, or a combination of both. Ongoing monitoring activities are the procedures designed to assess the quality of internal control performance over time and are built into the normal recurring activities of an entity (for example, regular management and supervisory activities). Separate evaluations focus on the continued effectiveness of a client's internal control.



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Appendix B

Compilation Reporting Requirements When Independence Is Impaired

Many accountants are finding that their independence with respect to a compilation client is impaired for a number of reasons. Examples of impairments include the performance of certain nonattest services, ownership in the client's business, or having certain relationships with the client. Prior to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*), an accountant was prohibited from including in his or her compilation report the reasons for an impairment of independence. An accountant could only state that he or she was not independent. Consequently, users who wanted to understand the reasons for an independence impairment needed to contact the client or the accountant for more information. Because of this interest on the part of users and to improve the overall transparency in the compilation report, the Accounting and Review Services Committee (ARSC) decided to remove the prohibition and allow an accountant, if he or she chooses, to state the reasons for an independence impairment in the compilation report.

Question—To what compilation engagements does SSARS No. 19 apply?

Answer—SSARS No. 19 applies to compilations of financial statements and other specified elements, accounts, or items of a financial statement and pro forma financial information performed in accordance with SSARSs. SSARS No. 19 does not apply to engagements to compile prospective financial information. Such engagements would be performed in accordance with AT section 301, *Financial Forecasts and Projections* (AICPA, *Professional Standards*). Paragraph .23 of AT section 301 states that the reason for a lack of independence should not be described in the compilation report.

Question—When may I start describing the reasons for lack of independence in my compilation report?

Answer—Although most provisions of SSARS No. 19 are effective for compilations and reviews of financial statements for periods ending on or after December 15, 2010, ARSC felt that it was important to permit accountants to disclose the reasons for an independence impairment in the compilation report as soon as practicable. Therefore, the standard has an exception that this specific provision (set forth in paragraph 2.21 of SSARS No. 19 [AR sec. 80 par. .21]—see the exhibit in this appendix) may be implemented early. Because SSARS No. 19 was issued in December 2009, you may begin using the provision in paragraph 2.21 (AR sec. 80 par. .21).

Question—May I disclose the reasons for the lack of independence only for December 2009 compilations and subsequent periods, or may I use it for earlier compilations (for example, November 2009 compilations)?

Answer—You may disclose the reasons for a lack of independence in a November (or earlier) compilation report as long as your report is released (or reissued) after December 30, 2009, which was the official issuance date of SSARS No. 19.

Question—May I use the new standard compilation report illustrated in SSARS No. 19 for compilations and reviews of financial statements for periods ending prior to December 15, 2010?

Answer—No. The effective date of SSARS No. 19 is for compilations and reviews of financial statements for periods ending on or after December 15, 2010. Early implementation of the new standard is not permitted, except for the one paragraph permitting disclosure of the reasons for a lack of independence in the compilation report. Therefore, you cannot use the new standard compilation report until SSARS No. 19 becomes effective.

Question—Does SSARS No. 19 require me to state the reasons why I'm not independent with respect to a compilation client?

Answer—No. SSARS No. 19 permits, but does not require, the accountant to disclose the reasons. You may simply state that you are not independent with respect to the client without disclosing the reasons.

Question—May I disclose the reasons for the lack of independence in one period and then not disclose the reasons in a subsequent period for the same client?

Answer—Yes. Each period for which a compilation report is issued for a client is treated as a separate compilation. For example, you may decide to disclose the reasons in a compilation report on financial statements for the period ended March 31, 2010, and then decide to not disclose the reasons in a compilation report on financial statements for the period ended June 30, 2010, or vice versa.

Question—Are there factors that I should consider before deciding to disclose the reason(s) for the impairment?

Answer—An accountant should exercise his or her professional judgment in making that decision. That judgment might include consideration of such factors as the number of reasons for independence impairment or the ability of the user of the compiled financial statements to understand the nature of the impairments.

Paragraph 2.21 of SSARS No. 19 (AR sec. 80 par. .21) states in part, "If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description." Therefore, if the accountant's independence is impaired for three reasons (for example, ownership, nonattest services, and family relationships), the accountant may decide that describing all three would make the report too lengthy or too confusing. Consequently, the accountant might decide to stay with the extant language and merely say that he or she is not independent. On the other hand, an accountant who is providing a nonattest service that impairs independence may feel that this information would be beneficial for users to know. Therefore, that accountant may decide to disclose the reason.

Question—Are there any limitations on what the report may say?

Answer—No. ARSC did not prescribe any requirements except that if an election is made to describe, then all the reasons for the impairment must be described. That means that an accountant could, if he or she chooses, write a paragraph three pages long to describe the reasons for the impairment. Although that length certainly isn't expected, ARSC anticipates and expects that some accountants will go into far greater detail than will others.

Question—Assuming an accountant is not independent for two reasons (for example, a family relationship and ownership) does each reason need to be in a separate paragraph?

Answer—No. An accountant may combine the reasons into a single paragraph. For example, assuming the accountant held an ownership interest in the client and the accountant's spouse was the CFO of the company, a description paragraph may be drafted, such as the following:

> I am not independent with respect to XYZ Company as of and for the year ended December 31, 2010, because I am a minority shareholder in XYZ Company and my spouse is an officer of XYZ Company.

Question—Assuming an accountant's independence is impaired because the accountant maintains a number of controls for the client, does each area of internal control need to be listed by the accountant, or may the accountant merely say that his or her independence is impaired because he or she maintained internal controls?

Answer—The provision is flexible and allows an accountant to provide as much detail as he or she feels appropriate in the circumstances. Therefore, the accountant may either state the areas of internal control maintained by the accountant or provide a general description of the reason or give no reason at all and merely say that he or she is not independent. In making this decision, the accountant should make sure that his or her description is not misleading. For example, if the accountant is maintaining only small aspects of internal control over financial reporting, the accountant would not want to describe the reason by saying that he or she is maintaining all controls for the client. Such a statement would be misleading and inaccurate.

Question—May this provision be used for review reports as described in the exposure draft?

Answer—No. Paragraph 3.2 of SSARS No. 19 (AR sec. 90 par. .02) states that the accountant is precluded from performing a review engagement if the accountant's independence is impaired for any reason.

Question—Where should I go if I have additional questions?

Answer—Members having additional questions regarding any of the provisions of SSARS No. 19 should contact the AICPA's hotline at 1.877.242.7212, through e-mail at aahotline@aicpa.org, or through the following website: www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx.

Exhibit: Reporting on Compiled Financial Statements When the Accountant Is Not Independent

[Note to readers: The following is paragraph 2.21 of SSARS No. 19 (AR sec. 80 par. .21).]

2.21. When the accountant is issuing a report with respect to a compilation of financial statements for an entity, with respect to which the accountant is not independent, the accountant's report should be modified. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA's Code of Professional Conduct. The accountant should indicate his or her lack of independence in a final paragraph of the accountant's compilation report. An example of such a disclosure would be

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

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company;

b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company; or

c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.

Appendix C

Reporting on Compiled or Reviewed Financial Statements for Periods Ended On or After December 15, 2010, With Comparative Financial Statements for Periods Ended Before December 15, 2010

Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*), was effective for compilations and reviews of financial statements for periods ending on or after December 15, 2010. Among other things, SSARS No. 19 revised the reporting requirements for compilation and review engagements. Accountants have questioned how they should report when comparative financial statements are presented and the prior year compilation or review was not performed in accordance with SSARS No. 19.

AR section 200, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*), has been revised to reflect conforming changes necessary due to the issuance of SSARS No. 19. The revised AR section 200 establishes standards for reporting on comparative financial statements of a nonissuer when financial statements of one or more periods presented have been compiled and reported on or reviewed in accordance with SSARS No. 19.

Because the updating of a prior year report on financial statements that the accountant compiled or reviewed in accordance with pre-SSARS No. 19 literature is not a compilation or review of those financial statements (but merely the updating of a report on a service previously performed and reported on), the accountant may use the SSARS No. 19 reporting format to update his or her prior year report. Reissuing his or her report using the pre-SSARS No. 19 report format is not required.

The following is an example of a compilation report on comparative financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for the years ended December 31, 2010, and 2009.

Accountant's Compilation Report

[*Appropriate Salutation*]

I (We) have compiled the accompanying balance sheets of XYZ Company as of December 31, 2010, and 2009, and the related statements of income, retained earnings, and cash flows for the years then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilations in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

The following is an example of a review report on comparative financial statements prepared in accordance with U.S. GAAP for the years ended December 31, 2010, and 2009.

Independent Accountant's Review Report

[*Appropriate Salutation*]

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 2010, and 2009, and the related statements of income, retained earnings, and cash flows for the years then ended. A review includes primarily applying analytical procedures to management's (owners') financial data and making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the reviews in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) report. Based on my (our) reviews, 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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Appendix D

Schedule of Changes Made to the Text From the Previous Edition

As of March 1, 2011

This schedule of changes identifies areas in the text and footnotes of this guide that have been changed from the previous edition. Entries in the table of this appendix reflect current numbering, lettering (including those in appendix names), and character designations that resulted from the renumbering or reordering that occurred in the updating of this guide.

Reference	*Change*
Preface	Updated.
Former paragraph 1.02 and observations and suggestions box in former paragraph 1.03	Deleted for the passage of time.
Paragraphs 1.03 and 1.06–.07	Revised for clarification.
Observations and suggestions box in former paragraph 1.07	Deleted for the passage of time.
Paragraph 1.12	Revised for clarification.
Former paragraph 1.16 and illustration 1-2	Deleted for the passage of time.
Observations and suggestions box in paragraph 1.15	Revised for clarification.
Footnote * in paragraph 1.21	Added.
Paragraph 1.27	Revised for clarification.
Observations and suggestions box in former paragraph 1.44	Deleted for the passage of time.
Chapter 2 title	Revised for clarification.
Paragraph 2.02	Revised for clarification.
Heading before former paragraph 2.03, former paragraph 2.03, heading before former paragraph 2.05, and former paragraphs 2.05–.06	Deleted for the passage of time.
Paragraphs 2.04–.05 and 2.09	Revised for clarification.
Paragraphs 2.10–.14	Added.
Paragraph 2.18	Revised for clarification.
Former paragraphs 2.30–.45	Moved to chapter 3.
Observations and suggestions box in former paragraph 2.32	Moved to chapter 3.

(continued)

Reference	*Change*
Former exhibit 2-1 and paragraph 2.61	Moved to chapter 3.
Observations and suggestions box in paragraph 2.33	Added for clarification.
Paragraphs 2.47–.62	Added for clarification.
Observations and suggestions box before paragraph 2.63	Added for clarification.
Paragraph 2.63	Revised for clarification.
Chapter 3	Added for clarification.
Former paragraphs 3.01–.05 and 3.08–.128	Moved to chapter 4.
Former paragraphs 3.06–.07	Deleted for the passage of time.
Paragraphs 3.01–.16	Moved from chapter 2.
Observations and suggestions box in paragraph 3.03	Revised for clarification.
Paragraphs 3.17–.33	Added for clarification.
Exhibit 3-1 and paragraph 3.34	Moved from chapter 2 and revised for clarification.
Paragraphs 3.35–.36	Added for clarification.
Former paragraphs 4.01, 4.05–.29, and exhibit 4-1	Moved to chapter 5.
Heading and subheading before former paragraph 4.02 and former paragraphs 4.02–4.03, subheading before former paragraph 4.04 and former paragraph 4.04	Deleted for the passage of time.
Observations and suggestions box after former paragraph 4.114	Deleted for clarification.
Paragraphs 4.01–.126	Moved from chapter 3.
Paragraphs 4.02, 4.04–.05, heading after paragraph 4.05, 4.09, 4.14, 4.38, 4.96, 4.109, and 4.117	Revised for clarification.
Footnote * in paragraph 4.05	Added.
Paragraphs 5.01–.20, 5.28–.33, and exhibit 5-1	Moved from chapter 4.
Observations and suggestions box in paragraph 5.15	Revised for clarification.
Paragraphs 5.21–.27	Added for clarification.
Exhibit 5-1 and paragraph 5.33	Revised for clarification.
Paragraphs 5.34–.35	Added for clarification.

Reference	*Change*
Appendix A	Revised for clarification.
Appendix B	Revised for clarification.
Appendix C	Added.
Exhibit	Added.
Glossary	Updated.
Index	Updated.

Exhibit

Compilations and Reviews of Personal Financial Statements

Introduction

Accountants may be engaged to compile or review personal financial statements. AR section 80, *Compilation of Financial Statements*, and AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), are applicable to compilations and reviews of personal financial statements in the same manner as to compilations and reviews of financial statements of commercial entities. The purpose of this exhibit is to provide specific guidance regarding how those AR sections are applied in compilations and reviews of personal financial statements.

Accounting Considerations

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 274-10-35-1 states that personal financial statements should present assets at their estimated current values and liabilities at their estimated current amounts at the date of the financial statements. Paragraphs 4–15 of FASB ASC 274-10-35 describe the methods used to determine the estimated current values of assets and estimated current amount of liabilities. In addition, personal financial statements prepared in accordance with accounting principles generally accepted in the United States of America require sufficient disclosures to make the financial statements adequately informative. In accordance with FASB ASC 274-10-50-2, the following would be disclosed:

a. A clear indication of the individuals covered by the financial statements

b. That assets are presented at their estimated current values and liabilities are presented at their estimated current amounts

c. Either of the following:

  i. The methods used in determining the estimated current values of major assets and the estimated current amounts of major liabilities

  ii. The methods used in determining the major categories of assets and liabilities

d. Changes in item (*c*) methods from one period to the next

e. If assets held jointly by the person and by others are included in the statements, the nature of the joint ownership

f. If the person's investment portfolio is material in relation to his or her other assets and is concentrated in one or a few companies or industries, the names of the entities or industries and the estimated current values of the securities

g. If the person has a material investment in a closely held business, at least the following:

i. The name of the entity and the person's percentage of ownership

ii. The nature of the business

iii. 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 (for example, accounting principles generally accepted in the United States of America, income tax basis, or cash basis) and any significant loss contingencies

h. Descriptions of intangible assets and their estimated useful lives

i. The face amount of life insurance the individuals own

j. Nonforfeitable rights that do not have the characteristics discussed in FASB ASC 274-10-35-11, for example, pensions based on life expectancy

k. All of the following tax information:

i. The methods and assumptions used to compute the estimated income taxes on the differences between estimated current values of assets and the estimated current amounts of liabilities and their tax bases

ii. 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 method of disposal, realization, or liquidation and the tax laws and regulations in effect at the time of disposal, realization, or liquidation

iii. Unused operating losses and capital loss carryforwards

iv. Other unused deductions and credits, with their expiration periods, if applicable

v. The differences between the estimated current values of major assets and the estimated current amounts of major liabilities or categories of assets and liabilities and their tax bases

vi. The excess or deficit of the estimated current values of major assets or categories of assets over their tax bases

l. Maturities, interest rates, collateral, and other pertinent details relating to receivables and debt

m. Noncancellable commitments that do not have the characteristics discussed in FASB ASC 274-10-35-13, for example, operating leases

Generally accepted accounting principles (GAAP) other than those discussed in FASB ASC 274 also apply to personal financial statements and the preparer is required to consider other applicable GAAP such as FASB ASC 450, *Contingencies*, and FASB ASC 850, *Related Party Disclosures*.

FASB ASC 274 also includes an illustrative personal financial statement.

The accountant also may compile or review personal financial statements that are prepared in conformity with a comprehensive basis of accounting that presents assets and liabilities at values and amounts other than estimated current values and amounts. For purposes of personal financial statements, other comprehensive bases of accounting include, for example, historical cost, tax, and cash.

Internal Control With Respect to Personal Financial Statements

Internal control over financial reporting includes the design and implementation of those policies and procedures deemed necessary to provide reasonable assurance that financial statements are fairly presented in accordance with the applicable financial reporting framework.

Although an individual typically does not have a formal system of internal control over financial reporting, an individual usually has some controls that provide for the preparation of his or her financial statements. For example, an individual usually has controls sufficient for him or her to identify amounts of assets owned and liabilities owed. Regardless of the formality of controls, an individual is still responsible for having those controls in place that allow for the preparation of his or her personal financial statements in accordance with the applicable financial reporting framework.

Accountants may be engaged to perform certain nonattest services that require the accountant to design, implement, or maintain certain aspects of an individual's internal control. The accountant should be aware that the performance of these services may impair the accountant's independence. An accountant who is not independent may perform a compilation engagement but is required to disclose the fact that the accountant is not independent in the accountant's compilation engagement. An accountant is required to be independent to perform a review engagement. In making a judgment about whether he or she is independent, the accountant should be guided by the AICPA Code of Professional Conduct.

Although the accountant is not required to assess internal control in a compilation or review engagement, the requirements with respect to management's acknowledgment of its responsibility for internal control over financial reporting and the accountant's requirement to disclose such responsibility in the compilation or review report remains intact.

Establishing an Understanding With the Client

The accountant is required, in either a compilation or review engagement, to establish an understanding with his or her client regarding the services to be performed and to document the understanding through a written communication with management. This is usually performed through the use of an engagement letter. The required elements of the understanding are included in paragraph .03 of AR section 80 with respect to compilation engagements and in paragraph .04 of AR section 90 with respect to review engagements.

The following is an illustration of an engagement letter for a compilation of personal financial statements.

Standard Engagement Letter for a Compilation of Personal Financial Statements

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will compile, from information you provide, the annual [*and interim, if applicable*] financial statements of James and Jane Person as of and for the year ended December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a compilation is to assist you in presenting financial information in the form of financial statements. We will utilize information that is your representation without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

c. the prevention and detection of fraud.

d. identifying and ensuring that you comply with the laws and regulations applicable to your activities.

e. making all financial records and related information available to us.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of your internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform you of any material errors and of any evidence or information that comes to our attention during the performance of our compilation procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our compilation procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, during the period covered by the engagement letter, the accountant's independence is or will be impaired, insert the following:

> *We are not independent with respect to James and Jane Person. We will disclose that we are not independent in our compilation report.*

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services . . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

____

James Person

____

Jane Person

____

Date

In addition, if the compiled financial statements are not expected to be used by a third party and the accountant does not expect to issue a compilation report on the financial statements, the accountant should include in the engagement letter an acknowledgment of the client's representation and agreement that the financial statements are not to be used by third parties.

The following illustration shows how an accountant may draft an engagement letter for a review of personal financial statements.

Standard Engagement Letter for a Review of Personal Financial Statements

[*Appropriate Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

We will review the financial statements of James and Jane Person as of and for the year ended December 31, 20XX, and issue an accountant's report thereon in accordance with Statements on Standards for Accounting and Review Services (SSARSs) issued by the American Institute of Certified Public Accountants (AICPA).

The objective of a review is to obtain limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

You are responsible for

a. the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].

b. designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

c. the prevention and detection of fraud.

d. identifying and ensuring that you comply with the laws and regulations applicable to your activities.

e. making all financial records and related information available to us.

f. providing us, at the conclusion of the engagement, with a letter that confirms certain representations made during the review.

We are responsible for conducting the engagement in accordance with SSARSs issued by the AICPA.

A review includes primarily applying analytical procedures to your financial data and making inquiries of you. A review is substantially less in scope that an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review does not contemplate obtaining an understanding of your internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion regarding the financial statements as a whole.

Our engagement cannot be relied upon to disclose errors, fraud, or illegal acts. However, we will inform you of any material errors and of any evidence or information that comes to our attention during the performance of our review procedures that fraud may have occurred. In addition, we will report to you any evidence or information that comes to our attention during the performance of our review procedures regarding illegal acts that may have occurred, unless they are clearly inconsequential.

If, for any reason, we are unable to complete the review of your financial statements, we will not issue a report on such statements as a result of this engagement.

Our fees for these services. . . .

We will be pleased to discuss this letter with you at any time. If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

____

[*Signature of accountant*]

Acknowledged:

____

James Person

____

Jane Person

____

Date

Fraud and Illegal Acts in a Compilation or Review of Personal Financial Statements

Neither a compilation nor a review contemplates assessing fraud risk. However, evidence or information may come to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred.

In a compilation or review of personal financial statements, the client has direct control over all decisions. As such, the individual typically does not have to be concerned about employee theft or fraud. However, because of the lack of sophistication of internal control with most individuals, there may be an increased risk of fraud or material misstatement of the financial statements.

Additionally, fraud or illegal acts may be committed by the client's agents, such as investment advisors and insurance agents. It is important that the client understand that he or she is responsible for the prevention and detection of fraud and illegal acts. In addition, it is important in a review of personal financial statements that the accountant, in accordance with paragraph .19 of AR section 90, asks the client about the client's knowledge of any fraud or suspected fraud affecting the client where the fraud could have a material effect on the financial statements. If evidence or information comes to the accountant's attention during the performance of compilation or review procedures that fraud or an illegal act may have occurred, the accountant should follow the guidance in paragraph .54 of AR section 80 and paragraph .61 of AR section 90, respectively.

Representation Letters

During an engagement to compile or review financial statements, a client makes representations to the accountant, both oral and written, in response to specific inquiries as part of review procedures or through the financial statements. Such representations from the client are an important part of the information gathered by the accountant. In an engagement to review financial statements, an accountant is required to obtain written representations from the client for all financial statements and periods covered by the accountant's review report. The accountant is not required to obtain such written representations in an engagement to compile financial statements. However, given the nature of compilations of personal financial statements, many accountants feel that it is a best practice to obtain such written representations in a compilation engagement.

The requirements with respect to written representations in a review of financial statements are included in paragraph .22 of AR section 90.

The following is an illustration of a client representation letter that may be obtained in a review of personal financial statements. The illustrative client representation letter may be modified as appropriate for those instances in which the accountant determines to obtain a client representation letter in a compilation engagement.

> [*Date*][1]
>
> To [*the Accountant*]
>
> We are providing this letter in connection with your review of the [*identification of financial statements*] of [*James and Jane Person*] as of [*dates (for example, December 31, 20X1, and December 31, 20X2)*] and for the [*periods of review (for example, for the years then ended)*] for the purpose of obtaining limited assurance that that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*]. We confirm that we are responsible for the fair presentation of the financial statements in accordance with [*the applicable financial reporting framework*] and the selection and application of the accounting policies.
>
> Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person using the information would be changed or influenced by the omission or misstatement.[2]
>
> We confirm, to the best of our knowledge and belief, (as of [*the date of the accountant's review report*]) the following representations made to you during your review:
>
> 1. The financial statements referred to previously are fairly presented in accordance with [*the applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America)*].
> 2. We have made our financial records and related data available to you.
> 3. No material transactions exist that have not been properly recorded in the accounting records underlying the financial statements.
> 4. We acknowledge our responsibility for the preparation and fair presentation of the financial statements in accordance with [*the applicable financial reporting framework (for*

[1] This date should be the date that the client presents and signs the letter. In no event should the letter be presented and signed prior to the date of the accountant's review report.

[2] The qualitative discussion of materiality used in this letter is adapted from Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.

example, accounting principles generally accepted in the United States of America)].

5. We acknowledge our responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.
6. We acknowledge our responsibility to prevent and detect fraud.
7. We have no knowledge of any fraud or suspected fraud affecting us where the fraud could have a material effect on the financial statements.
8. We have no plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities.
9. No material losses exist that have not been properly accrued or disclosed in the financial statements.
10. None of the following exist:
    a. Violations or possible violations of laws or regulations, whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
    b. Unasserted claims or assessments that our lawyer has advised us are probable of assertion that must be disclosed in accordance with Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 450, *Contingencies*.[3]
    c. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB ASC 450.
11. We have satisfactory title to all owned assets, and no liens or encumbrances on such assets exist, nor has any asset been pledged as collateral, except as disclosed to you and reported in the financial statements.
12. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
13. The following have been properly recorded or disclosed in the financial statements:
    a. Related party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.

---

[3] If the client has not consulted a lawyer regarding litigation, claims, and assessments, the representation might be worded as follows:

> We are not aware of any pending or threatened litigation, claims, or assessments or unasserted claims or assessments that are required to be accrued or disclosed in the financial statements in accordance with Financial Accounting Standards Board *Accounting Standards Codification* 450, *Contingencies*, and we have not consulted a lawyer concerning litigation, claims, or assessments.

b. Guarantees, whether written or oral, under which we are contingently liable.

c. Significant estimates and material concentrations known to us that are required to be disclosed in accordance with FASB ASC 275, *Risks and Uncertainties*. [*Significant estimates are estimates at the balance sheet date that could change materially with the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year*.]

14. We are in agreement with the adjusting journal entries you have recommended, and they have been posted to our accounts (if applicable).

15. To the best of our knowledge and belief, no events have occurred subsequent to the date of the statement of financial condition and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial statements.[4]

16. We have responded fully and truthfully to all inquiries made to us by you during your review.

____
James Person

____
Jane Person

Reporting on Compiled or Reviewed Personal Financial Statements

When the accountant is engaged to report on compiled personal financial statements or submits personal financial statements that are reasonably expected to be used by a third party, the financial statements should be accompanied by a written report. Personal financial statements reviewed by an accountant should be accompanied by a written report. The accountant's objective in reporting on the financial statements is to prevent misinterpretation of the degree of responsibility the accountant is assuming when his or her name is associated with the financial statements.

Paragraph .17 of AR section 80 outlines the basic elements of an accountant's compilation report. Paragraph .28 of AR section 90 outlines the basic elements of an accountant's review report.

If an accountant submits personal financial statements to his or her client that are not expected to be used by a third party, the accountant is not required to issue a compilation report. In those circumstances, the accountant's communication requirements are discussed in paragraphs .22–.24 of AR section 80.

---

[4] If the accountant dual dates his or her report, the accountant should consider whether obtaining additional representations relating to the subsequent event is appropriate.

The following is an illustration of an accountant's standard compilation report on compiled personal financial statements. If the financial statements are prepared in accordance with the income tax basis of accounting, the titles would be revised to refer to the statement of financial condition—income tax basis and the statement of changes in net worth—income tax basis.

Accountant's Compilation Report

[*Appropriate Salutation*]

I (We) have compiled the accompanying statement of financial condition of James and Jane person as of December 31, 20XX, and the related statement of changes in net worth for the year then ended. I (We) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

James and Jane Person are responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist James and Jane Person in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

The client may request that the accountant compile financial statements that omit substantially all disclosures required by an applicable financial reporting framework (for example, accounting principles generally accepted in the United States of America or the income tax basis of accounting), including disclosures that might appear in the body of the financial statements. In those instances, the accountant should follow the guidance in paragraph .20 of AR section 80.

Also, the accountant may issue a compilation report on personal financial statements when he or she is not independent with respect to the client. Statement on Standards for Accounting and Review Services No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*), provides a reporting option in those circumstances in which the accountant may disclose the reasons for an independence impairment in his or her compilation report. When the accountant is reporting on compiled financial statements when he or she is not independent, the accountant should follow the guidance in paragraph .21 of AR section 80.

Finally, AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* (AICPA, *Professional Standards*), provides for an alternative form of standard compilation report when the prescribed form or related instructions call for a departure from generally accepted accounting principles by specifying a measurement principle not in conformity with generally accepted accounting principles or by failing to request the disclosures required by generally accepted accounting principles.

The following is an illustration of an accountant's standard review report on personal financial statements prepared in accordance with accounting principles generally accepted in the United States of America. If the financial statements are prepared in accordance with the income tax basis of accounting, the titles would be revised to refer to the statement of financial condition—income tax basis and the statement of changes in net worth—income tax basis.

Independent Accountant's Review Report

[*Appropriate Salutation*]

I (We) have reviewed the accompanying statement of financial condition of James and Jane Person as of December 31, 20XX, and the related statement of changes in net worth for the year then ended. A review includes primarily applying analytical procedures to James and Jane Person's financial data and making inquiries of James and Jane Person. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (We) do not express such an opinion.

James and Jane Person are responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

My (Our) responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. Those standards require me (us) to perform procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. I (We) believe that the results of my (our) procedures provide a reasonable basis for our report.

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 accounting principles generally accepted in the United States of America.

[*Signature of accounting firm or accountant, as appropriate*]

[*Date*]

Departures From the Applicable Financial Reporting Framework

An accountant who is engaged to compile or review personal financial statements may become aware of a departure from the applicable financial reporting framework (including inadequate disclosure) that is material to the financial statements. Paragraphs .27–.29 of AR section 80 and paragraphs .34–.36 of AR section 90 provide the appropriate guidance with respect to a compilation or review of financial statements, respectively.

A common departure from accounting principles generally accepted in the United States of America in personal financial statements is a failure by the client to 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 following is an illustration of how such a departure from accounting principles generally accepted in the United States of America may be disclosed in the accountant's compilation or review report:

> Accounting principles generally accepted in the United States of America require that personal financial statements 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. The accompanying financial statements do not include such a provision and the effect of this departure from accounting principles generally accepted in the United States of America has not been determined.

Reporting on Personal Financial Statements Included in Written Personal Financial Plans

AR section 600, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* (AICPA, *Professional Standards*), provides an exemption from AR section 80 for personal financial statements that are included in written personal financial plans prepared by the accountant, and it specifies the form of written report required under the exemption.

Glossary

applicable financial reporting framework. The financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.

assurance engagement. An engagement in which an accountant issues a report designed to enhance the degree of confidence of third parties and management about the outcome of an evaluation or measurement of financial statements (subject matter) against an applicable financial reporting framework (criteria).

attest engagement. An engagement that requires independence, as defined in AICPA *Professional Standards*.

financial reporting framework. A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements.

financial statements. A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term *financial statements* ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework, but it can also refer to a single financial statement or financial statements without notes.

management. The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

nonissuer. All entities except for those defined in Section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), the securities of which are registered under Section 12 of that act (15 U.S.C. 78l), or that is required to file reports under Section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the Securities Act of 1933 (15 U.S.C. 77a, et seq.), and that it has not withdrawn.

other comprehensive basis of accounting (OCBOA). A definite set of criteria, other than accounting principles generally accepted in the United States or International Financial Reporting Standards, having substantial support underlying the preparation of financial statements prepared pursuant to that basis.

Examples of an OCBOA are as follows:

a. A basis of accounting that the reporting entity uses to comply with the requirements or financial reporting provisions of a governmental regulatory agency to whose jurisdiction the entity is subject (for example, a 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 basis of accounting and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets). Ordinarily, a modification would have substantial support if the method is equivalent to the accrual basis of accounting for that item and if the method is not illogical.

review evidence. Information used by the accountant to provide a reasonable basis for the obtaining of limited assurance.

submission of financial statements. Presenting to management financial statements that an accountant has prepared.

third party. All persons, including those charged with governance, except for members of management.

those charged with governance. The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance are specifically excluded from management, unless they perform management functions.

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