2013

Compilation and review developments - 2013/14; Compilation and Review alert; Audit risk alerts

American Institute of Certified Public Accountants (AICPA)

Compilation
and Review
Developments

ISBN 978-1-94023-502-8

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ARACRV13P

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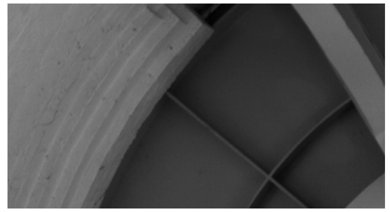

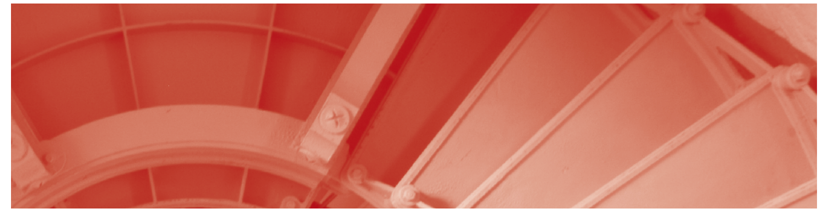

ALERT

Compilation and Review Developments

2013/14

AICPA®

Strengthening Engagement Quality
Safeguarding Financial Reporting

ALERT

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SAFEGUARDING FINANCIAL REPORTING

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Notice to Readers

This 2013/14 edition of the AICPA Alert *Compilation and Review Developments* replaces the AICPA Alert *Compilation and Review Developments—2012/13*.

This Compilation and Review Alert (alert) is intended to provide accountants with an update on recent practice issues and professional standards that affect compilation and review engagements. This alert also can be used by an entity's internal management to address areas of concern.

This publication is an other compilation and review publication, as defined in paragraph .20 of AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements* (AICPA, *Professional Standards*). Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply the Statements on Standards for Accounting and Review Services.

If applying the guidance included in an other compilation and review publication, the accountant should, using professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement as appropriate. The guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior committee of the AICPA.

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The AICPA gratefully acknowledges those members of the Accounting and Review Services Committee and the AICPA Technical Issues Committee who helped identify the interest areas for inclusion in this alert.

Feedback

The alert *Compilation and Review Developments* is published annually. As you encounter issues that you believe warrant discussion in next year's alert, please feel free to share them with us. Any other comments you have about the alert also would be appreciated. You may e-mail these comments to A&APublications@aicpa.org.

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How This Alert Helps You

.01 This Compilation and Review Alert (alert) helps practitioners plan and perform compilation and review engagements and can also be used by an entity's management to plan and prepare in advance of the engagement. This alert discusses recent Statements on Standards for Accounting and Review Services (SSARSs) developments, addresses current and emerging practice issues, and provides valuable information regarding accounting and reporting developments. You should refer to the full text of accounting and compilation and review pronouncements as well as the full text of any rules or publications that are discussed in this alert.

Economic Developments

The Current Economy

.02 In performing a compilation or review engagement, accountants should possess an understanding of the industry in which the client operates.[1] This understanding may be affected by general economic conditions. For example, interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions, are likely to have an effect on an entity's industry, its business and, ultimately, its financial statements. Considering the effects of these external forces may help the accountant better understand the client's industry and the client's business. For review engagements, these considerations may also help the accountant determine the specific nature, timing, and extent of review procedures to be performed.

.03 During 2012 and into 2013, the U.S. economy has continued to recover. The S&P 500 and the Dow Jones Industrial Average have reached all-time highs during 2013. The Chicago Board Options Exchange Volatility Index (VIX) is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock option prices and is considered by many to indicate investor sentiment, market volatility, and the best gauge of fear in the market. The VIX has continued to show a steady decline during 2013. As of November 2013, the 52-week high and low are 23.23 and 11.05, respectively. The volatility shows there is still some uncertainty; however, the continued downward trend shows that investors believe the economy and market are improving.

Key Economic Indicators

.04 The following key economic indicators reaffirm the recovery of the economy during 2013: gross domestic product (GDP), unemployment, and the federal fund rate. The GDP measures output of goods and services by labor and property within the United States. It increases as the economy grows or decreases as it slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 2.5 percent in the second quarter of 2013, based on the advance estimate (third estimate). Real GDP increased at an annual rate of 1.1 percent in the first quarter of 2013. The increase in real GDP in the second quarter primarily reflected positive contributions from personal consumption expenditures, exports, nonresidential fixed investment, private

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[1] Paragraph .06 of AR section 80, *Compilation of Financial Statements*, and paragraph .08 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), respectively.

inventory investment, and residential fixed investment that were partly offset by a negative contribution from federal government spending. Imports, which are a subtraction in the calculation of GDP, increased.

.05 From September 2012 to September 2013, the unemployment rate fluctuated between 7.8 percent and 7.2 percent. A rate of 7.6 percent represents approximately 11.8 million people who are unemployed. Based on the Bureau of Labor Statistics (BLS), from May 2012 to May 2013, the average employment growth was 169,000 per month, which is an increase over 2011. During that same time period, the number of long-term unemployed (those jobless for 27 weeks or more) has decreased by 687,000, indicating more growth in the economy. Based on the BLS, the number of people employed part-time for economic reasons decreased to 7.6 million during the first quarter of 2013, down from 8 million at the end of 2012, and the average workweek for all private employees had increased 0.1 hour through the first quarter of 2013. Together, these statistics illustrate the overall improvement in the economy.

.06 The Board of Governors of the Federal Reserve System (Federal Reserve) decreased the target for the federal funds rate more than 5.0 percentage points, from its high of 5.25 percent prior to the financial crisis, to less than 0.25 percent, where it remains into November 2013. The Federal Reserve indicates that the target range for federal funds rates of 0 percent to 0.25 percent is appropriate for as long as the unemployment rate stays above 6.5 percent, inflation over the next two years is projected to be less than 0.5 percent above the 2 percent longer-run goal, and longer-term inflation projections continue to be low.

Government Shutdown

.07 The U.S. government entered a partial shutdown on October 1, 2013, due to Congress's failure to enact legislation appropriating funds for fiscal year 2014. The shutdown lasted 16 days and was brought to an end by agreements meant to avoid defaulting on government issued debt. Both the budget and debt issues will be revisited in the near future by Congress.

.08 Several effects of the partial shutdown can be found throughout the country. The IRS is projecting a week delay in the start of the 2013 tax filing season due to lost time for development and testing of needed updates to the filing system. Another effect is the negative economic effect for areas that rely on tourism related to national parks and monuments. These attractions were closed during the shutdown and as such many travelers cancelled their travel plans. Additionally, many businesses with government contracts felt the effect in that they had to lay off employees.

Legislative and Regulatory Developments

American Taxpayer Relief Act of 2012

.09 On January 1, 2013, Congress passed the American Taxpayer Relief Act of 2012 (the act) after reaching an agreement to avoid the "fiscal cliff."

.10 With some modifications that increase taxes on the wealthiest Americans, the act permanently extends provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 and the Jobs and Growth Tax Relief Reconciliation Act of 2003. It also permanently patches the alternative minimum tax and indexes it to inflation.

.11 The act's nontax features include one-year extensions of emergency unemployment insurance and agricultural programs and yet another postponement of automatic cuts in Medicare payments to physicians.

.12 The act temporarily extends many other tax provisions that had lapsed at midnight on December 31, 2012, and others that had expired a year earlier, reinstating them retroactively. Some of the provisions of the law that may be of interest include the following:

- Taxpayers age 70$^{1}/_{2}$ or older can donate up to $100,000 from Roth or traditional IRAs to certain charitable organizations without including the amount of their IRA withdrawals in gross income.
- The above-the-line deduction for qualified higher education tuition-related expenses for taxpayers with adjusted gross income below certain limits was extended.
- The deduction limitation for qualified conservation contributions is increased from 30 percent to 50 percent of the donor's contribution base over the amount of other charitable contributions.
- The deduction for contributions of apparently wholesome food from any trade or business is not limited to the taxpayer's basis in the food. The deduction is limited to 10 percent of the taxpayer's aggregate net income.

.13 Among the tax items not addressed by the act was the temporarily lower 4.2 percent rate for employees' portions of the Social Security payroll tax, which was not extended and has reverted to 6.2 percent.

The Dodd-Frank Wall Street Reform and Consumer Protection Act

.14 The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act) was signed into law in July 2010 in response to weaknesses in the financial services industry that are believed to have contributed to the economic recession. The main goals of the reform are to lower the systemic risks to the financial system and enhance consumer protections.

.15 The Dodd-Frank Act implements changes that affect the oversight and supervision of financial institutions and creates many new agencies. One of the main changes brought about by the Dodd-Frank Act was the creation of the Financial Stability Oversight Council (FSOC) that oversees financial institutions. The role of the FSOC, which is chaired by the Secretary of the Treasury, is to identify risks to financial stability and promote market discipline.

.16 Implementation of the Dodd-Frank Act is far behind schedule. Of the almost 400 rules that the act requires be finalized, only 161 are final as of October 1, 2013. One hundred twenty-one rules have not been proposed.

Recent AICPA Independence and Ethics Developments

Changes to Interpretation No. 101-3

.17 The AICPA's Professional Ethics Executive Committee (PEEC) adopted a number of significant revisions to Interpretation No. 101-3, "Nonattest Services," under Rule 101, *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .05).

Activities Related to Attest Services

.18 The PEEC adopted a provision clarifying that financial statement preparation, cash-to-accrual conversions, and reconciliations are considered outside the scope of the attest engagement (compilation, review, or audit) and, therefore, constitute nonattest services subject to the general requirements of Interpretation No. 101-3. This provision is effective for engagements covering periods beginning on or after December 15, 2014.

.19 This clarification does not mean that accountants and auditors cannot prepare financial statements for their review and audit clients. Instead, the accountant or auditor would have to apply the general requirements of Interpretation No. 101-3 to maintain his or her independence as a result of the preparation service. If the accountant's or auditor's independence is not impaired, the accountant or auditor can perform the review or audit.

Internal Audit Assistance Services

.20 The PEEC adopted revisions describing the effect that performing ongoing and separate evaluations would have on a member's independence. Although the revisions include a description of these two types of monitoring activities, members seeking further guidance on distinguishing between ongoing and separate evaluations are directed to the Committee of Sponsoring Organizations of the Treadway Commission's *Internal Control—Integrated Framework*.

.21 The revisions make it clear that performing ongoing evaluations is akin to accepting responsibility for maintaining the client's internal control. As such, the management participation threat is so significant that no safeguards can eliminate or reduce the threat to an acceptable level and independence would be impaired.

.22 However, when it comes to separate evaluations, the revisions clarify that members should use judgment in determining whether otherwise permitted internal audit services performed may result in a significant management participation threat to independence, considering factors such as the significance of the controls being tested, the scope or extent of the controls being tested in relation to the overall financial statements of the client, as well as the frequency of the internal audit services. If the threat to independence is considered significant, the member should apply safeguards to eliminate or reduce the threat to an acceptable level. If no safeguards could reduce the threat to an acceptable level, then independence would be impaired.

.23 These revisions are effective for engagements covering periods beginning on or after December 15, 2013.

Partner Equivalents

.24 The PEEC adopted, with minor revisions, the partner equivalent proposals contained in the September 19, 2012, exposure draft. Under the adopted guidance, a partner equivalent would need to apply certain independence requirements that are applicable to partners. Partner equivalents are those professional employees who are not partners but who have (*a*) the authority to bind the firm to conduct an attest engagement[2] without partner approval or (*b*) ultimate responsibility for the conduct of an attest engagement, including the authority to sign or affix the firm's name to an attest report or to issue, or authorize others to issue, an attest report on behalf of the firm without partner approval.

.25 These revisions will be effective for engagements covering periods beginning on or after December 15, 2014. This additional time allows members to identify individuals who should be considered partner equivalents and to implement the requirements.

Ethics Codification

.26 The PEEC is proposing to restructure and codify the AICPA Code of Professional Conduct (AICPA, *Professional Standards*) (AICPA code) so that members and other users of the AICPA code can apply the rules and reach correct conclusions more easily and intuitively. To achieve this, the PEEC is proposing to restructure the AICPA code into several parts organized by topic, edit the AICPA code using consistent drafting and style conventions, incorporate a conceptual framework for members in public practice and business, revise certain AICPA code provisions to reflect the conceptual framework approach (also known as the threats and safeguard approach), and, where applicable, reference existing nonauthoritative guidance to the relevant topic. It is the PEEC's intent to maintain the substance of the existing AICPA ethics standards. The PEEC believes this was achieved; however, during the process, the PEEC identified some areas that needed revision and have been highlighted as substantive changes. The AICPA expects to issue the revised code in early 2014.

New Structure of the Code

.27 The restructured AICPA code is divided into separate parts. The first part is the preface, which is applicable to all members and covers topics such as the structure of the code; the principles of professional conduct; the defined terms that are used in the code; nonauthoritative guidance; and new, revised, and pending interpretations. The remaining three parts are divided according to a member's practice. Part 1 is applicable to members in public practice, part 2 is applicable to members in business, and part 3 is applicable to all other members, such as those who are retired or unemployed. By structuring the AICPA code this way, the PEEC believes that members will be able to easily identify what provisions apply to them. For members who are both in public practice and business, content that is relevant to both parts appears in the corresponding citation (an explanation of numeric citations follows). The actual content differs only where necessary (for example, part 1 might refer to a firm, whereas part 2 might refer to employer).

Numeric Citations

.28 The new citation numbering system for the AICPA code looks like this: ET section X.XXX.XXX. The single digit that begins the citation identifies in which part the content resides. Accordingly, content from the preface begins with the single digit 0.XXX.XXX, whereas content for part 1 begins with

[2] The AICPA Code of Professional Conduct (AICPA, *Professional Standards*) defines an *attest engagement* as "... an engagement that requires independence as defined in the AICPA professional standards."

a 1.XXX.XXX, part 2 with a 2.XXX.XXX, and part 3 with a 3.XXX.XXX. Next are two sets of three digit numbers that identify the topics and, when applicable, subtopics or sections. To facilitate use, when a topic, subtopic, or section appears in two or more parts, the same number is used.

Rules of Conduct

.29 The bylaws of the AICPA require that members adhere to the rules of the AICPA code. This has not changed with the restructured code. However, the specific rule numbers are no longer being used. For example, Rule 101, *Independence* (AICPA, *Professional Standards*, ET sec. 101 par. .01), is now referred to as the Independence Rule. In addition, the manner in which the interpretations are aligned with the rules has changed. In the currently effective version of the AICPA code, content is aligned under the applicable rules, whereas in the restructured AICPA code, the rules are aligned with the interpretations under a broad topic. For example, the Contingent Fees Rule and Commission and Referral Fees Rule and related interpretations will appear under ET section 1.500, "Fees and Other Types of Remuneration."

.30 Given this construct, there are some situations in which the rule appears multiple times in the AICPA code. For example, the Integrity and Objectivity Rule appears under the Integrity and Objectivity topic of both part 1 and part 2. However, the interpretations of this rule do not necessarily appear in both part 1 and part 2. Rather, they are aligned with the member's practice. For example, under the Integrity and Objectivity topic, there is a subtopic called Conflicts of Interest in both parts 1 and 2. In part 1, an interpretation addresses conflicts of interest concerns when a member in public practice is also a director of an entity. However, this interpretation does not appear in part 2 because it would not be applicable to such members.

.31 Finally, all ethics rulings have been redrafted as interpretations and codified under the appropriate topic.

Conceptual Framework

.32 The PEEC proposes to incorporate two conceptual framework interpretations into the restructured AICPA code: one for members in public practice and another very similar one for members in business. In addition, for members in public practice who provide attest services[3] to clients, there is a conceptual framework for independence that focuses on the specific threats to independence. The conceptual framework for independence is a redraft of the extant ET section 100-1, *Conceptual Framework for AICPA Independence Standards* (AICPA, *Professional Standards*). These conceptual framework interpretations are designed to assist members when they encounter a relationship or circumstance that creates threats to their compliance with the rules and when the AICPA code contains no specific guidance to assist the member. When specific guidance is absent, under the conceptual framework interpretations, the member should evaluate whether that circumstance or relationship would lead a reasonable and informed third party that is aware of the relevant information to conclude that there is an unacceptable threat to the member's compliance with the rules.

.33 In addition to the two conceptual framework interpretations, certain interpretations were recast to reflect the conceptual framework approach that

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[3] See footnote 2.

represents a significant change. For example, the existing interpretation that prohibits a covered member from having a direct financial interest in a client is proposed to read as follows:

> If a covered member had or was committed to acquire any direct financial interest in an attest client during the period of the professional engagement, the self-interest threat to the covered member's compliance with the Independence Rule would not be at an acceptable level and could not be reduced by the application of safeguards. Accordingly, independence would be impaired.

.34 The PEEC believes this will enhance understanding of the AICPA code by providing additional context to the code and guidance on the application of the framework. However, recasting will not change the substance of the existing AICPA code by allowing members to apply judgment where none is permitted today. For example, as noted in the preceding statement, if a covered member holds stock in an audit client, the only safeguard that would eliminate or sufficiently mitigate the self-interest threat to independence would be to eliminate the interest or cease being a covered member, which is the same requirement as under the current AICPA code. Thus, recasting does not weaken the code or allow for judgment where none is permitted now. Some interpretations in the code, such as those for acts discreditable, false advertising, and confidentiality, do not lend themselves to a conceptual framework approach and, as such, were not recast. For those interpretations, PEEC applied only drafting and style conventions.

Nonauthoritative Guidance

.35 The primary objectives of restructuring the AICPA code is so that members and other users can apply the code more easily, thus, minimizing the risk of misapplication. To assist members in understanding and applying the AICPA code, periodically, the Ethics division develops nonauthoritative guidance (for example, frequently asked questions and Basis for Conclusions documents) that resides outside the AICPA code. As described in ET section 0.500, "Nonauthoritative Guidance," during the restructuring, the PEEC reevaluated the nonauthoritative guidance and either proposed that some of it be made authoritative and incorporated into the revised AICPA code or aligned links to the nonauthoritative content with the relevant topic.

Current Practice Issues

.36 The AICPA staff has identified some challenging practice issues and in this section, we provide recommendations to assist practitioners in addressing them in an efficient, high quality manner.

Engagement Letters

.37 Paragraph .02 of AR section 80, *Compilation of Financial Statements*, and paragraph .03 of AR section 90, *Review of Financial Statements* (AICPA, *Professional Standards*), require that the accountant establish an understanding with management regarding the services to be performed and document the understanding through a written communication with management for compilation and review engagements, respectively. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed. A formal contract is another suitable form of written agreement. A verbal understanding with management is insufficient.

.38 Current SSARSs do not require that the engagement letter be signed by either the accountant or management. However, the purpose of the engagement letter is to ensure that both the accountant and management understand the objectives of the engagement, management's responsibilities, the accountant's responsibilities, and the limitations of the engagement. Having both parties sign the engagement letter evidences agreement on those important aspects of the engagement and therefore is considered a very strong best practice. The proposed SSARSs *Preparation of Financial Statements, Compilation Engagements*, and *Review of Financial Statements* will require that the engagement letter be signed by both the accountant and management for all engagements to prepare financial statements, perform a compilation of financial statements, or perform a review of financial statements, respectively.

.39 Both current and proposed SSARSs, however, leave the period that the engagement letter should cover to the accountant's judgment. The engagement letter can cover multiple services and address both nonattest and attest services (for example, an engagement to prepare monthly financial statements and review the annual financial statements for an entity). Some practitioners use what is often referred to as "evergreen letters," which cover multiple years or may run in perpetuity. Although not prohibited, the practice of obtaining such multiyear or evergreen engagement letters is strongly discouraged because the understanding between the accountant and management tends to lose clarity as time passes. This practice may also create the perception of the engagement being a "continuous" one, thereby potentially prolonging the point in time at which a statute of limitations may start to run. From a risk management perspective, an accountant can mitigate the risk of an engagement being considered "continuous" by obtaining a new engagement letter at least annually.

Subsequent Events

.40 In a review engagement, the accountant is required to consider inquiring of the client's management concerning subsequent events that could have a material effect on the financial statements. If management advises the accountant that such subsequent events exist, the accountant should request that management consider the possible effects on the financial statements, including adequate disclosure. If the subsequent event is not properly accounted for or disclosed, the accountant should modify the accountant's review report to disclose the departure from the applicable financial reporting framework. The management representation letter should also include a statement by management that subsequent events have been appropriately reflected in the financial statements.

.41 In a compilation engagement, the accountant does not have any responsibility with respect to subsequent events unless evidence or information about a subsequent event that has a material effect on the financial statements comes to the accountant's attention. If such evidence or information comes to the accountant's attention, the accountant should request that management consider the possible effects on the financial statements, including adequate disclosure. If the subsequent event is not properly accounted for or disclosed, the accountant should modify the accountant's compilation report to disclose the departure from the applicable financial reporting framework.

.42 Since the accountant's compilation or review report is dated as of the completion of the compilation or review procedures, the date of the report can never be earlier than the date that management discloses as the date through which subsequent events were evaluated. In a review engagement, the accountant's review report, the representation, and the note disclosure should all be dated as of the same date. The accountant may want to discuss these dating issues with management prior to the start of the engagement and include them in the engagement letter.

Review Evidence and Analytical Procedures in a Review Engagement

.43 Many accountants have come to consider the review engagement as an exercise in performing analytical procedures and making inquiries of management. However, a review is more than that; a review is an assurance engagement and requires the accumulation of review evidence that will provide the accountant with limited assurance that there are no material modifications that should be made to the financial statements.

.44 The use of analytical procedures in a review differs from their use in an audit. 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.

.45 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

.46 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.

Example: If an accountant is engaged to review the financial statements of a private school, the accountant might develop expectations for net tuition revenue by obtaining the number of students by grade level, tuition pricing by grade level, policies for discounts applicable to families with multiple students, tuition assistance approved by the school's board, and other data points, many of which are from nonaccounting sources. With this information, the accountant can calculate an expected value for net tuition revenue by first determining the disaggregated components of revenue as follows:

Gross Tuition

Less:

Discounts applicable to families having multiple children enrolled

Less:

Tuition assistance

Equals:

Net tuition

.47 In accordance with paragraph .18 of AR section 90, the accountant should investigate any fluctuations or relationships that differ from expected values by a significant amount by inquiring of management and performing other procedures as necessary in the circumstances. For additional illustrative examples of analytical procedures and more detailed guidance on evaluating the actual results of analytical procedures, readers should refer to the AICPA Guide *Compilation and Review Engagements* and appendix A, "Illustrative Analytical Procedures for Review Engagements," of this alert.

Reporting on Supplementary Information in a Compilation or Review Report

.48 Regardless of whether the financial statements are compiled or reviewed, the accountant should clearly indicate the degree of responsibility, if any, he or she is taking with respect to information presented for supplementary analysis purposes. 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. When the accountant has reviewed the basic financial statements, an explanation should be included in the review report or in a separate report on the other data. The report should state that the review has been made 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 and that either

- the other data accompanying the financial statements are presented only for purposes of additional analysis 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 purposes of additional analysis and have not been

subjected to the inquiry and analytical procedures applied in the review of the basic 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 provide any assurance on such data.

.49 Unless engaged to review or compile supplementary information, the SSARSs do not require the accountant to apply procedures to any information presented for supplementary analysis purposes, including required supplementary information. Although not specified in the SSARSs, the location of the explanation in the accountant's report (when the accountant does not issue a separate report on the supplementary information) that addresses the supplementary information is typically at the end of the accountant's compilation or review report in a separate paragraph. For illustrative examples of an accountant's compilation or review report containing the explanatory language required for supplementary information, readers are encouraged to refer to the *Compilation and Review Engagements* guide.

Required Supplementary Information: Interpretation No. 17, "Required Supplementary Information That Accompanies Compiled Financial Statements," of AR section 80 (AICPA, *Professional Standards*, AR sec. 9080 par. .66), and Interpretation No. 11, "Required Supplementary Information That Accompanies Reviewed Financial Statements," of AR section 90 (AICPA, *Professional Standards*, AR sec. 9090 par. .44), as applicable, provide guidance when an accountant is engaged to compile or review financial statements that a designated accounting standard setter (such as the Financial Accounting Standards Board [FASB] or the Governmental Accounting Standards Board) requires be accompanied by required supplementary information and such required supplementary information is omitted.

Variable Interest Entities

.50 Accountants engaged to compile or review financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) should consider whether the requirements concerning variable interest entities (VIEs) are applicable to the financial statements. Paragraph 38A of FASB *Accounting Standards Codification®* (ASC) 810-10-25 requires a reporting entity with a variable interest in a VIE to assess whether the reporting entity has a controlling financial interest in the VIE and, thus, is the VIE's primary beneficiary.

.51 As background, such an assessment should include an assessment of the characteristics of the reporting entity's variable interest(s) and other involvements (including involvement of related parties and de facto agents), if any, in the VIE, as well as the involvement of other variable interest holders. Additionally, the assessment should consider the VIE's purpose and design, including the risks that the VIE was designed to create and pass through to its variable interest holders.

.52 A reporting entity is deemed to have a controlling financial interest in a VIE if it has both of the following characteristics:

a. The power to direct the activities of a VIE that most significantly affect the VIE's economic performance

b. The obligation to absorb losses of the VIE that could potentially be significant to the VIE or the right to receive benefits from the VIE that could potentially be significant to the VIE

.53 Only one reporting entity, if any, is expected to be identified as the primary beneficiary of a VIE. Although more than one reporting entity could have the characteristic in (*b*), only one reporting entity, if any, will have the power to direct the activities of a VIE that most significantly affect the VIE's economic performance.

.54 Practitioners often find that, in practice, management refuses to perform the required assessment and instructs the accountant engaged to compile or review the financial statements not to perform the assessment. So, accountants often wonder whether this scenario is cause for the accountant to withdraw from the engagement due to management's refusal to provide information or because of a scope limitation. Technical Questions and Answers (TIS) section 9150.29, "Effects on Compilation and Review Engagements When Management Does Not Assess Whether the Reporting Entity Is the Primary Beneficiary of a Variable Interest Entity and Instructs the Accountant to Not Perform the Assessment" (AICPA, *Technical Practice Aids*), provides that the accountant is not required to withdraw from the engagement as the failure to perform the assessment and management's instructions to the accountant not to perform the assessment are a departure from GAAP, not a refusal to provide information or a scope limitation. Instead, the accountant should consider whether modification of the standard report is adequate to disclose this departure from GAAP. The full text of this nonauthoritative TIS section provides more guidance.

Applicability of the Compilation Standards When Performing Controllership or Other Management Services

.55 Paragraph .01 of AR section 80 requires the accountant to comply with the provisions of AR section 80 whenever he or she submits financial statements to a client or to third parties. *Submission of financial statements*[4] is defined in AR section 60, *Framework for Performing and Reporting on Compilation and Review Engagements* (AICPA, *Professional Standards*), as presenting to management financial statements that the accountant has prepared.

.56 Members in public practice[5] often accept engagements to perform controllership or other management services for their clients. If the accountant is in public practice and is not a stockholder, partner, director, officer, or employee of the entity, the accountant is required to comply with the requirements of AR section 80.

.57 If the accountant is a stockholder, partner, director, officer, or employee of the entity, the accountant is not required to comply with the requirements of AR section 80. If the accountant in public practice determines

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[4] See the "On the Horizon" section of this alert for information on proposed Statements on Standards for Accounting and Review Services that would change the applicability of the compilation standards.

[5] *Public practice* is defined in paragraph .30 of ET section 92, *Definitions* (AICPA, *Professional Standards*), as consisting of the performance of professional services for a client by a member or a member's firm.

that he or she does not want to comply with the requirements of AR section 80, the accountant may issue a communication that makes clear the accountant's involvement in the preparation of the financial statements. Though such communication need not be in writing, an example is as follows:

> 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.

.58 If the accountant is not in the practice of public accounting, the issuance of a report in accordance with SSARSs would be inappropriate. However, the preceding report may be used.

.59 Questions concerning whether the accountant is in public practice are often difficult and the accountant may wish to consult with the AICPA Professional Ethics Hotline.

Reference to the Accountant's Report in Notes to the Financial Statements

.60 Paragraph .18 of AR section 80 and paragraph .29 of AR section 90 require that each page of the financial statements that were compiled or reviewed by the accountant include a reference such as "See accountant's compilation report," "See independent accountant's compilation report," or "See accountant's review report." Given that the financial statements are management's responsibility, this may be a challenging requirement to meet. Often, management is willing to include such a reference on the face of the balance sheet and related statements but not on the notes.

.61 Because the related notes are an integral part of the financial statements, the requirement does extend to the notes. If the accountant is unable to have management include the reference on each page of financial statements (which includes the notes), in accordance with paragraph .11 of AR section 60, the accountant should document the justification for the departure from the SSARSs requirements.

Reporting When a Different Level of Service Is Applicable to the Prior Period

Prior Period Is Audited

.62 When reporting on current period compiled or reviewed financial statements, and the prior period financial statements were audited, the requirements of paragraph .29 of AR section 200, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*), are applicable. This paragraph provides that the accountant should issue an appropriate compilation or review report on the current-period financial statements and, if the auditor's report on the prior period financial statements is not reissued, the report on the current period should include as a separate paragraph an appropriate description of the responsibility assumed for the financial statements of the prior period. The separate paragraph should indicate all of the following:

a. That the financial statements of the prior period were audited previously

b. The date of the previous report

c. The type of opinion expressed previously

d. If the opinion was other than unmodified, the substantive reasons therefor

e. That no auditing procedures were performed after the date of the previous report

These provisions apply regardless of whether the accountant is the continuing accountant or successor accountant.

Prior Period Compiled or Reviewed—Continuing Accountant

.63 In accordance with paragraph .08 of AR section 200, a continuing accountant who performs a higher level of service with respect to the financial statements of the current period should update his or her report on the financial statements of a prior period presented with those of the current period. A continuing accountant who performs a lower level of service with respect to the financial statements of the current period should either (*a*) include as a separate paragraph of his or her report a description of the responsibility assumed for the financial statements of the prior period or (*b*) reissue his or her report on the financial statements of the prior period. Please see the preceding section for additional guidance when the prior period financial statements were audited.

Illustrative Accountant's Reports

.64 The accountant should refer to paragraphs .38–.39 of AR section 200 for illustrative accountant's compilation and review reports on comparative financial statements when different levels of service were applicable to the periods presented.

Prior Period Compiled or Reviewed by a Predecessor Accountant

.65 In accordance with paragraph .17 of AR section 200, when the financial statements of a prior period have been compiled or reviewed by a predecessor whose report is not presented and the successor has not compiled or reviewed those financial statements, the successor should make reference in an additional paragraph(s) of his or her report on the current-period financial statements to the predecessor's report on the prior-period financial statements. This reference should include the following matters:

a. A statement that the financial statements of the prior period were compiled or reviewed by another accountant (other accountants)

b. The date of his or her (their) report

c. If the financial statements of the prior period were compiled, a statement that the other accountant(s) did not audit or review the financial statements and, accordingly, did not express an opinion or provide any assurance about whether the financial statements are in accordance with the applicable financial reporting framework

d. If the financial statements of the prior period were reviewed, a statement that, based on his or her review, the other accountant(s) are 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 *e.* A description or a quotation of any modifications of the standard report and of any paragraphs emphasizing a matter regarding the financial statements

Bookkeeping and Financial Statement Preparation Services

.66 For years, members have called the AICPA's Technical Hotline and inquired at conferences whether certain actions meant they had "submitted" financial statements. For example, if a CPA was performing bookkeeping services for the client and the client "pushed the button" to print the financial statements, many CPAs would claim that they have not "submitted" the financial statements. The fact that the client "pushed the button" meant that the client (or more accurately, the client's software) prepared the financial statements. Other CPAs might, legitimately, argue the opposite. So too would some members argue that even if they pushed the button, they didn't prepare the financial statements because all they did was prepare adjustments at month's end.

.67 Currently, the compilation standards are applicable when the accountant is engaged to report on compiled financial statements or submits financial statements to a client or to third parties. Further, in SSARSs, *the submission of financial statements* is defined as "presenting to management financial statements that an accountant has prepared." Therefore, the compilation standards apply today when the CPA is either (1) engaged to perform a compilation, or (2) when the CPA prepares financial statements on behalf of management. Accountants may refer to TIS section 9150.25, "Determining Whether Financial Statements Have Been Prepared by the Accountant" (AICPA, *Technical Practice Aids*), for guidance regarding when the work that they have performed results in financial statement preparation.

.68 The proposed SSARS would eliminate the submission requirement and make the compilation literature apply only when the accountant is engaged to perform a compilation service.

.69 This proposed revised SSARS, and other proposed SSARSs, are discussed further in the "On the Horizon" section of this alert.

Peer Reviews of Compilation and Review Engagements

Matters for Consideration

.70 In performing peer review engagements, peer reviewers use Matter for Further Consideration (MFC) forms to document issues identified based on the review of individual engagements or the firm's system of quality control. The MFC form captures issues at the most granular level. Matters included on these forms may stay as matters or may be elevated to findings or deficiencies. A matter is noted as a result of evaluating whether an engagement submitted for review was performed and reported on in conformity with applicable professional standards. The evaluation includes reviewing the financial statements or information, the related accountant's reports, and the adequacy of procedures performed, including related documentation.

.71 Depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding. Findings will also be evaluated and, after considering their nature and relative importance, including whether they are material to the understanding of the report or financial statements, or represent the omission of a critical procedure including documentation, may not get elevated to a deficiency. Alternatively, a matter may develop into a finding and get elevated to a deficiency. That deficiency may or may not be further elevated to a significant deficiency.

.72 In 2012, the AICPA Peer Review Program reported that approximately 34,600 engagements were reviewed, of which approximately 22,600 were compilation or review engagements. Based on peer reviews performed during 2010-2012, the items that follow were common examples of noncompliance (both material and immaterial) with professional standards.

Common Peer Review Findings—Review Engagements

Analytical Procedures—Failure to Document Expectations When Performing Analytical Procedures and to Compare Results to Those Expectations

.73 For the relevant authoritative guidance applicable to this finding, practitioners should review paragraphs .25–.26 of AR section 90, which describe the accountant's documentation requirements in a review engagement. These requirements include documenting the expectations for analytical procedures performed and the factors considered in the development of the expectations.

Management Representations—Omissions and Errors

.74 For the relevant authoritative guidance applicable to this finding, practitioners should review paragraphs .22–.24 of AR section 90, which explain that written representations from management are required for all financial statements and periods covered by the accountant's review report. The accountant should request that management provide a written representation related to the following matters:

- Management's acknowledgment of its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework
- Management's belief that the financial statements are fairly presented in accordance with the applicable financial reporting framework
- Management's acknowledgement of its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements
- Management's acknowledgement of its responsibility to prevent and detect fraud
- 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
- Management's full and truthful response to all inquiries
- Completeness of information
- Information concerning subsequent events

.75 The representation letter ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry.

Basic Reporting Elements—Failure to Follow the Basic Report Elements

.76 Practitioners should note that financial statements reviewed by the accountant should be accompanied by a written report. Paragraphs .27–.33 of AR section 90 describe the reporting requirements. The basic elements of the report are as follows:

- Title
- Addressee
- Introductory paragraph
- Management's responsibility for the financial statements
- Accountant's responsibility
- Results of engagement
- Signature of the accountant
- Date of the accountant's report

Engagement Letters—Omissions and Errors

.77 Readers should refer to the "Current Practice Issues" section of this alert for information on engagement letters.

Reporting on Comparative Financial Statements—Referencing All Periods Reviewed and to Supplemental Information Provided in the Accountant's Review Report

.78 For the relevant authoritative guidance applicable to this finding, practitioners should review AR section 200, which describes the requirements for reporting on comparative financial statements. See also paragraph .60 of AR section 90 and paragraph .53 of AR section 80 for the requirements applicable to reporting on supplementary information, and the "Current Practice Issues" section of this alert for more information on reporting on comparative financial statements.

Common Peer Review Findings—Compilation Engagements

Failure to Properly Modify Accountant's Compilation or Review Report for a Departure From GAAP Resulting From Financial Statements Containing Current Liabilities Without the Appropriate Caption

.79 FASB ASC 210-10-05-04 states that the balance sheets of most entities show separate classifications of current assets and current liabilities (commonly referred to as classified balance sheets) permitting ready determination of working capital. FASB ASC 210-10-45 establishes the requirements for presenting comparative financial statements. Failure to properly classify current assets and current liabilities in a classified balance sheet is a departure from GAAP. Paragraphs .27–.29 of AR section 80 and paragraphs .34–.36 of AR section 90 require that if the financial statements are not revised, the accountant should consider whether modification of the standard report is adequate to disclose the departure. 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 a result of the accountant's procedures. 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 engagement and provide no further services with respect to those financial statements.

Failure to Appropriately Title Financial Statements

.80 Practitioners should note that financial statements require suitable titles. Examples of these titles with respect to financial statements prepared in accordance with GAAP include balance sheet, statement of comprehensive income or statement of net income and comprehensive income, statement of retained earnings or changes in shareholders' equity, and statement of cash flows. Other suitable titles can be found in chapter 2, "Compilation Engagement Performance Requirements," of the *Compilation and Review Engagements* guide.

.81 If the financial statements are not suitably titled, the accountant should consider modification of the accountant's compilation or review report to disclose the departure from the applicable financial reporting framework.

Reporting on the Financial Statements—Failure to Include Basic Report Elements

.82 Paragraph .17 of AR section 80 lists the basic elements of the accountant's compilation report, which include the following:

- Title
- Addressee
- Introductory paragraph
- Paragraph describing management's responsibility
- Paragraph describing accountant's responsibility
- Results of engagement
- Signature of the accountant
- Date of the accountant's report

.83 The introductory paragraph should specify the date or period(s) covered by the financial statements.

Inappropriate Form of a Standard Compilation Report—Failure to Identify the Non-GAAP Financial Reporting Framework Used

.84 The applicable financial reporting framework should be included in the compilation report as described in paragraphs .17 and .19 of AR section 80.

> **AICPA Peer Review Program:** Training and frequently asked questions about the AICPA Peer Review program can be found at www.aicpa.org/InterestAreas/PeerReview/Pages/PeerReviewHome.aspx. Questions can also be directed to the Peer Review Hotline at 919.402.4502 or prptechnical@aicpa.org.

Financial Reporting Framework for Small- and Medium-Sized Entities

.85 The AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs™) is designed for America's small business community. It delivers financial statements that provide useful, relevant information in a simplified, consistent, cost-effective way. The FRF for SMEs framework may be used when GAAP are not required.

.86 The FRF for SMEs accounting framework draws upon a blend of traditional accounting principles and accrual income tax methods of accounting. It utilizes historical cost as its primary measurement basis. In addition, it provides management with a suitable degree of optionality when choosing accounting policies to better meet the needs of the end users of the financial statements. The framework avoids prescriptive, detailed standards and voluminous disclosure requirements. Being a more intuitive and understandable framework for small business owners and the users of their financial statements, the framework lays out principles that encourage the use of professional judgment in the particular circumstances of a transaction or event.

.87 The AICPA believes that the framework is criteria suitable for general use financial statements and can be used by users external to the entity. An important pillar of the framework is that its use requires the exercise of professional judgment. The key attributes of the framework are as follows:

- Objectivity. The framework is free from bias.
- Measurability. The framework permits reasonably consistent measurements.
- Completeness. The framework is sufficiently complete so that those relevant factors that would alter a conclusion about the financial statements are not omitted.
- Relevance. The framework is relevant to financial statement users.

Scope and Characteristics of Entities Utilizing the FRF for SMEs Accounting Framework

.88 The FRF for SMEs accounting framework has been developed for small- to medium-sized entities that require reliable non-GAAP financial statements for internal use and external uses. The framework can be used by entities in many industry groups and may also be used by unincorporated, as well as incorporated, entities. The framework is not intended to be a substitute for GAAP when GAAP-based financial statements are necessary, as determined by the management of a private company and its financial statement users.

.89 A standard definition of small- and medium-sized entities does not exist in the United States of America. However, the term is intuitive, widely recognized, and effectively descriptive of the scope of entities for which the FRF for SMEs accounting framework is intended. Size criteria for determining what a small- or medium-sized entity is were deliberately not developed to quantify size. Rather, characteristics of typical entities that may utilize the framework are presented. Ultimately, the decision regarding which accounting framework best meets an entity's financial reporting needs rests with management.

.90 This list presents certain characteristics of typical entities that may utilize the FRF for SMEs accounting framework. These characteristics are not all-inclusive and are not presented as a list of required characteristics an entity must possess in order to utilize the framework:

- The entity does not have regulatory reporting requirements that essentially require it to use GAAP-based financial statements.
- A majority of the owners and management of the entity have no intention of going public.
- The entity is for-profit.
- The entity may be owner-managed, which is a closely held company in which the people who own a controlling ownership interest in the entity are substantially the same set of people who run the company.
- Management and owners of the entity rely on a set of financial statements to confirm their assessments of performance, cash flows, and of what they own and what they owe.
- The entity does not operate in an industry such as financial or government in which the entity is involved in transactions that require highly-specialized accounting guidance.
- The entity does not engage in overly complicated transactions.
- The entity does not have significant foreign operations.
- Key users of the entity's financial statements have direct access to the entity's management.
- Users of the entity's financial statements may have greater interest in cash flows, liquidity, statement of financial position strength, and interest coverage.
- The entity's financial statements support applications for bank financing when the banker does not base a lending decision solely on the financial statements but also on available collateral or other evaluation mechanisms not directly related to the financial statements.

Application of FRF for SMEs Accounting Framework Principles, Concepts, and Criteria

.91 The FRF for SMEs accounting framework was developed to address transactions that are typically encountered by private, for-profit, small-, and medium-sized entities. If the framework does not specifically address a transaction, other event, or condition, management should use its judgment and apply the general principles, concepts, and criteria contained in the framework when developing accounting policies. The development and application of those policies should result in financial information that is intended to be consistent with the financial statement concepts of the FRF for SMEs accounting framework.

Authority and Effective Date of the FRF for SMEs Accounting Framework

.92 The AICPA has no authority to require the use of the FRF for SMEs accounting framework for any entity. Therefore, use of the framework is purely optional. Management that prepares an entity's financial statements in accordance with the framework may represent or assert that such financial statements have been prepared in accordance with the AICPA's FRF for SMEs accounting framework, a special purpose framework.

.93 Because use of the framework is optional, there is no effective date for its implementation.

Maintenance of the FRF for SMEs Accounting Framework

.94 Appreciating the limited accounting resources that typical entities utilizing the FRF for SMEs accounting framework have, as well as the nature of their financial reporting, the framework is intended to be a stable platform that does not undergo frequent amending or updating. At the same time, it is intended to be responsive to the financial reporting needs of small- and medium-sized entities and, therefore, will be modified in response to significant developments in accounting and financial reporting matters affecting those entities.

.95 Accordingly, the task force and AICPA staff intend to monitor and assess input related to the implementation of the framework after its initial release and propose modifications as necessary. Afterwards, staff, with assistance from the task force, intends to review and propose amendments to the framework approximately every three or four years. Amendments will be primarily based on input from stakeholders and developments in accounting and financial reporting.

FRF for SMEs Toolkits

.96 The AICPA has developed free FRF for SMEs toolkits to help CPAs and CPA firms, financial statement users and small businesses learn about the FRF for SMEs reporting option. These toolkits contain overviews, sample illustrative financial statements, videos, PowerPoint presentations, and much more. There are three toolkits available: one for CPAs, one for financial statement users, and one for small businesses.

.97 The CPA firm toolkit provides both client facing and internal resources to help make the transition to the FRF for SMEs framework easier. The client facing materials include videos that highlight key benefits of the framework and a PowerPoint presentation to help practitioners introduce the framework to clients. The internal materials include a learning and implementation plan to help the practitioner plan and track the use of the items in the toolkit and training materials to use with your firm employees on the framework.

.98 The AICPA has created several resources to help users of financial statements understand the framework. These resources include illustrative financial statements, comparisons of the FRF for SMEs accounting framework to GAAP, tax basis, and other accounting frameworks, as well as frequently asked questions.

.99 The toolkit for small business includes a decision tool to help the company make an informed decision about choosing an accounting framework, a backgrounder that outlines why the FRF for SMEs framework was needed, and a template for a letter to stakeholders expressing your interest in using the FRF for SMEs framework.

.100 All of the resources are available free of charge at www.aicpa.org/INTERESTAREAS/FRC/ACCOUNTINGFINANCIALREPORTING/PCFR/Pages/Financial-Reporting-Framework.aspx.

.101 The AICPA's Accounting and Auditing Technical Hotline also provides members with free, high-quality technical assistance by phone concerning issues related to accounting and financial reporting, auditing and attestation, compilation, and review standards. Technical questions about the FRF for SMEs accounting framework can be directed to the technical hotline.

Decision Tool for Adopting FRF for SMEs

.102 Financial reporting frameworks consist of two groups: GAAP and special-purpose frameworks (SPFs). Special purpose frameworks, with the exception of the contractual basis of accounting, are commonly referred to as other comprehensive bases of accounting or OCBOA. Special purpose frameworks include cash basis, modified cash basis, tax basis, regulatory basis, contractual basis, and other non-GAAP bases of accounting that utilize a definite set of logical, reasonable criteria that are applied to all material items appearing in the financial statements. The FRF for SMEs framework is a special purpose framework.

.103 The AICPA has developed a tool to help owners and managers of a small- or medium-sized private business and CPAs serving those businesses to make an informed decision about choosing an accounting framework, including the FRF for SMEs framework, as an appropriate basis for the preparation of the entity's financial statements. The choice of a financial reporting framework rests with the owners and managers of a private company, in consideration of their needs and the needs of the users of their financial information. The tool is available online to AICPA members at the AICPA's Financial Reporting Center at www.aicpa.org/InterestAreas/FRC/AccountingFinancialReporting/PCFR/DownloadableDocuments/FRF-SME/FRFforSMEs˙DecisionTool.pdf.

.104 Management of an entity and the CPA practitioners who serve those entities may find the tool helpful in determining which accounting framework (or basis of accounting) is most suitable for the entity's financial reporting needs. By following the steps and assessing the considerations and circumstances outlined in the tool, a more informed decision about the choice of an accounting framework can be made. Readers should note that the tool is presented as a nonauthoritative aid and its use is not required.

AICPA Practice Aid *Accounting and Financial Reporting Guidelines For Cash- and Tax-Basis Financial Statements*

.105 Readers should also be aware that, should the cash-basis or tax-basis frameworks be more appropriate for an entity, the AICPA has available a practice aid *Accounting and Financial Reporting Guidelines For Cash- and Tax-Basis Financial Statements* that provides preparers with the guidelines and best practices to promote consistency and help resolve the often difficult questions regarding the preparation of cash- and tax-basis financial statements. Although nonauthoritative, this practice aid is the best source for such guidance. You can order this practice aid from www.cpa2biz.com (product no. APACTB12P [paperback], ACACTB12E [eBook], or APACTBO [online]).

Recent Activities of FASB's Private Company Council

.106 In May 2012, the Financial Accounting Foundation's Board of Trustees approved the establishment of the Private Company Council (PCC) to improve the standard-setting process for private companies. At the PCC's February 12, 2013, meeting, FASB and the PCC tentatively agreed on the criteria for determining whether and in what circumstances private companies should have alternatives within GAAP. Using those criteria, the PCC will develop, deliberate, and formally vote on proposed alternatives for private companies within GAAP. If endorsed by FASB, the proposed alternatives will be exposed for public comment. At the conclusion of the public comment process, the PCC will redeliberate the proposed alternatives and then submit them to FASB for a final decision on endorsement. FASB and the PCC also will use this guide to consider private company issues in standard-setting projects under active consideration on FASB's technical agenda.

.107 In June 2013, FASB endorsed three alternatives within GAAP that were proposed by the PCC. The proposals involve accounting for intangible assets acquired in business combinations, goodwill, and certain types of interest rate swaps. Exposure drafts are expected to be issued for public comment.

.108 The first proposal—derived from PCC Issue No. 13-01A, *Accounting for Identifiable Intangible Assets in a Business Combination*—modifies the requirement for private companies to separately recognize fewer intangible assets acquired in a business combination.

.109 The second proposal—derived from PCC Issue No. 13-01B, *Accounting for Goodwill Subsequent to a Business Combination*—would permit amortization of goodwill (the residual asset recognized in a business combination after recognizing all other identifiable assets acquired and liabilities assumed) and a simplified goodwill impairment model.

.110 The third proposal—derived from PCC Issue No. 13-03, *Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps*—would give private companies, other than financial institutions, the option to use two simpler approaches to accounting for certain types of interest rate swaps that are entered into by a private company for the purpose of economically converting its variable-rate borrowing to a fixed-rate borrowing.

.111 The effective dates will be determined after FASB and the PCC consider stakeholder feedback on the exposure drafts.

.112 In September 2013, FASB voted to propose changes designed to improve the relevance and reduce the complexity of development-stage entity financial reporting and expects to issue an exposure draft by the end of October that would apply to public and private entities.

On the Horizon

.113 Practitioners and management should keep abreast of accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to compilations and reviews. Remember that exposure drafts are nonauthoritative and cannot be relied upon until issued as a final, approved standard.

.114 Information on, and copies of, outstanding exposure drafts may be obtained from the various standard-setters' websites. These websites contain in-depth information about proposed standards and other projects in the pipeline. For projects that the Accounting and Review Services Committee (ARSC) has undertaken, readers should refer to the AICPA's Financial Reporting Center at www.aicpa.org/RESEARCH/STANDARDS/COMPILATIONREVIEW/ARSC/Pages/ARSC.aspx.

SSARSs Clarity Project, Including Significant Changes to the Compilation Standards

Proposed SSARSs Preparation of Financial Statements, Compilation Engagements, *and* Association With Financial Statements

.115 In October 2013, the ARSC exposed for public comment three proposed standards that, if passed as final standards, would significantly affect the literature for compilation engagements. The proposed standards are written in clarity format and have a comment end date of May 2, 2014. The proposed standards are as follows:

- A proposed revised compilation standard that would provide requirements and guidance to an accountant when engaged to perform a compilation engagement on historical financial statements.
- A new standard that would provide requirements and guidance when an accountant is engaged to prepare financial statements for a client but has not been engaged to perform a compilation, review, or audit with respect to those financial statements.
- A new standard that would provide requirements and guidance when an accountant agrees to permit the use of his or her name in a report, document, or written communication that also includes financial statements with respect to which the accountant did not issue a compilation, review, or audit report. The accountant may or may not have prepared the financial statements.

.116 The proposed revised compilation standard would revise the applicability of the compilation literature. Currently, AR section 80 applies when an accountant is engaged to report on compiled financial statements or submits financial statements to the client or to third parties. *Submission* is defined as "prepares and presents." Although submission worked satisfactorily as a trigger for the compilation service when SSARS No. 1 was issued in December 1978, cloud computing and other applications have made it difficult to determine who (or what) has prepared the financial statements. Take, for example, a situation in which an accountant performs bookkeeping services for a client. Perhaps the accountant has access to the client's cloud computing system and makes a few journal entries to record payroll tax payments, sales tax payments, and depreciation expenses for a given period. The company's internal bookkeeper records certain recurring expenses such as utilities and office expenses. At the end of each month, the bookkeeper prints out a copy of the financial statements for presentation to the board of directors. Has the accountant prepared those financial statements? The bookkeeper? The application itself?

.117 The ARSC proposal would eliminate the need for the accountant to determine an answer to that difficult question by eliminating the submission requirement and making the compilation literature apply when the accountant is engaged to perform a compilation service. Since the accountant would follow the compilation standard when engaged, the accountant would always be required to issue a compilation report. However, in order to differentiate the nonassurance compilation report from assurance (review and audit) reports, the ARSC has proposed to streamline the report so that the standard report is just one paragraph with no headings.

.118 The proposed standard would retain the existing requirement that the accountant modify the accountant's compilation report whenever the accountant's independence is impaired. The accountant would be required to obtain an engagement letter signed by both the accountant and the client's management. The proposed standard can be applied to financial statements with or without disclosures.

.119 The proposed preparation standard would apply when the accountant is engaged to prepare financial statements but is not engaged to perform an audit, review, or a compilation on those financial statements. A report would not be required—even when financial statements are expected to be used by or presented to a third party. Instead, the accountant would be required to include a legend on each page of the financial statements stating that no assurance is being provided. The proposed SSARS would require that the accountant obtain an engagement letter signed by both the accountant and the client's management. Like all other nonattest bookkeeping and accounting services engagements, the accountant would not be required to consider whether he or she is independent. The proposed standard can be applied to financial statements with or without disclosures.

.120 The proposed compilation and preparation SSARSs would result in a bright line between accounting (preparation) and reporting (compilation) services. The accountant would not have to be concerned about whether the financial statements would be used internally or would be used by third parties (including boards of directors). The following table illustrates the similarities and differences between the two proposed services:

	Compilation	*Preparation*
When does the standard apply?	When an accountant is engaged to perform a compilation.	When an accountant is engaged to prepare financial statements.
Is an engagement letter required?[6]	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	Yes	No
If the accountant is not independent, is that fact required to be disclosed?	Yes	N/A

(continued)

[6] The accountant may obtain one engagement letter that covers all services performed.

	Compilation	*Preparation*
Does the engagement require a report?	Yes	No, except if management refuses to include required disclosure that no CPA provides any assurance.
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit substantially all notes?	Yes	Yes

.121 The proposed association standard is essentially the same as pre-clarity AU section 504, *Association With Financial Statements.* The requirements and guidance with respect to association with unaudited financial statements is being moved to the SSARSs so that the auditing literature deals only with audit matters. The proposed standard applies when the accountant permits the use of his or her name in a report, document, or written communication containing financial statements that the accountant has not issued an audit, review, or compilation report on. In those cases, the accountant would be required to read the financial statements to see if there are any obvious material misstatements.

Proposed SSARSs, Review of Financial Statements *and* Review of Financial Statements—Special Considerations

.122 In addition to the trio of proposed standards that were exposed for public comment in October 2013, the ARSC had previously exposed for public comment a pair of SSARSs dealing with reviews of financial statements. The proposed SSARSs are converged with the requirements of AU-C section 930, *Interim Financial Information* (AICPA, *Professional Standards*). The result will be consistency between limited assurance engagements. Additionally, the proposed SSARSs may be applied to historical financial information other than historical financial statements such as the following:

- Specified elements, accounts, or items of a financial statement
- Supplementary information
- Required supplementary information
- Financial information included in a tax return

.123 The proposed SSARSs include the following new requirements:

- A requirement to exercise professional judgment—which is implicit in current SSARSs.
- A requirement to obtain an engagement letter signed by both the accountant and management.
- A requirement to include headings in the accountant's review report.

- A requirement to name the city and state of the issuing office in the accountant's review report. The requirement may be satisfied via the letterhead.

.124 Additionally, with respect to reporting on reviewed financial statements prepared in accordance with a special purpose framework (including OCBOA frameworks), the accountant would be required to

- consider whether the financial statements are suitably titled and describe how the framework differs from GAAP.
- consider whether the financial statements include informative disclosures similar to GAAP, where appropriate.
- include an emphasis-of-matter paragraph in the accountant's review report that states that the financial statements are prepared in accordance with a special purpose framework, refers to the note that describes the framework, and states that the framework is not GAAP.
- include an other-matter paragraph that restricts the use of financial statements prepared in accordance with a contractual basis of accounting or a regulatory basis of accounting (unless intended for general use).

.125 In addition to the requirement to include an emphasis-of-matter paragraph in the accountant's review report on financial statements prepared in accordance with a special purpose framework, the proposed SSARSs will also require the inclusion of emphasis-of-matter or other-matter paragraphs in the accountant's review report in the following instances:

- When management revises financial statements for a subsequently discovered fact and the accountant's report on the revised financial statements differs from that initially issued
- When management is required to present required supplementary information
- When the accountant considers it necessary to draw users' attention to a matter

.126 The accountant will be required to communicate with management when it expects to include an emphasis-of-matter or other-matter paragraph in the accountant's review report.

ARSC Timetable for Issuance of the Clarified SSARSs

.127 The following represents the ARSC's tentative timeline with respect to issuance of the clarified SSARSs:

October 2013	The ARSC exposed for public comment the following three proposed SSARSs: • *Preparation of Financial Statements* • *Compilation Engagements* • *Association With Financial Statements*

(continued)

November 5-8, 2013	ARSC to meet in Charleston, SC and consider comments received on the exposure draft of the proposed SSARSs *Review of Financial Statements* and *Review of Financial Statements—Special Considerations* and consider the following draft SSARSs: • *Framework for Performing and Reporting on Compilation and Review Engagements* • *Compilation of Pro Forma Financial Information* • *Compilation of Prospective Financial Information* The ARSC will consider voting the proposed SSARSs *Framework for Performing and Reporting on Compilation and Review Engagements* and *Compilation of Pro Forma Financial Information* for public comment.
May 2, 2014	The comment date ends with respect to the following proposed SSARSs: • *Preparation of Financial Statements* • *Compilation Engagements* • *Association With Financial Statements* • *Framework for Performing and Reporting on Compilation and Review Engagements* • *Compilation of Pro Forma Financial Information*
May 6-8, 2014	ARSC to meet in Baltimore, MD and consider comments received on the five proposed SSARSs for which comments were due May 2, 2014.
August 2014 (specific dates to be determined)	ARSC to meet (location to be determined) and consider drafts of the following proposed SSARSs and consider voting to issue as final clarified SSARSs: • *Framework for Performing and Reporting on Compilation and Review Engagements* • *Association With Financial Statements* • *Preparation of Financial Statements* • *Compilation Engagements* • *Compilation of Pro Forma Financial Information* • *Review of Financial Statements*

All proposed SSARSs are expected to be effective for calendar 2015 engagements and early implementation is expected to be permitted.

Resource Central

.128 The following are various resources that practitioners performing compilation and review engagements may find beneficial.

Publications

.129 Practitioners may find the following publications useful. Choose the format best for you—online, eBook, or print.

- *Codification of Statements on Standards for Accounting and Review Services* (product no. ACODSSARS13P [paperback] or ACODSSARS13E [eBook])
- AICPA Guide *Compilation and Review Engagements* (2013) (product no. AAGCRV13P [paperback], WRC-XX [online], or AAGCRV13E [eBook])
- AICPA Practice Aid *Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements* (product no. APACTB12P [paperback], APACTBO [online], or APACTB12E [eBook])
- AICPA Alert *Independence and Ethics Developments—2012/13* (product no. ARAIET12P [paperback], WIA-XX [online], or ARAIET12E [eBook])
- Compilation and Review Set (product no. WSR-XX [online])
- *U.S. GAAP Financial Statements—Best Practices in Presentation and Disclosure* (formerly, *Accounting Trends & Techniques*) (product no. ATTATT13P [paperback] or WNG-XX [online])
- *IFRS Financial Statements—Best Practices in Presentation and Disclosure 2012/2013* (product no. ATTIFRS12P [paperback] or WIF-XX [online])
- *Financial Reporting Framework for Small- and Medium-Sized Entities With Implementation Resources* (product no. AFRFSME13P [paperback], AFRFSME13E [eBook], or AFRFSMEO [online])

Continuing Professional Education

.130 The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry, including the following:

- *AICPA's Annual Accounting and Auditing Workshop* (product no. 736189 [text] or 187197 [DVD with manual]). Whether you are in industry or public practice, this course keeps you current and informed and shows you how to apply the most recent standards.
- *Internal Control: Essentials for Financial Managers, Accountants, & Auditors* (product no. 731905 [text]). This course will provide you with a solid understanding of systems and control documentation at the significant process level.
- *International Versus U.S. Accounting: What in the World is the Difference?* (product no. 745941 [text]). Understanding the differences between International Financial Reporting Standards (IFRSs) and GAAP is becoming more important for businesses of

all sizes. This course outlines the major differences between IFRS and GAAP.

- *IFRS Essentials with GAAP Comparison: Building a Solid Foundation* (product no. 741605 [text]). This course provides you with a greater understanding of what you need to know as the acceptance of international standards continues to grow.

.131 Among the many courses, the following are specifically related to compilation and review engagements:

- *Accounting Services, Compilations and Reviews: Effective Risk Management* (product no. 732827 [text])
- *Auditor/Accountant Communications* (product no. 733744 [text])
- *Compilation, Review, and Accounting Services* (product no. 733485 [text])
- *Performing Compilation and Review Engagements* (product no. 154700 [online] and 739700HS [CD-ROM])
- *Performing Analytical Procedures in a Review Engagement* (product no. 154710 [online])
- *Performing Inquiries in a Review Engagement* (product no. 154720 [online])
- *Introduction to Compilations and Reviews* (product no. 154730 [online])
- *Performing a Compilation Engagement Under SSARS 19* (product no. 154740 [online])
- *How to Perform a Review Under SSARS No. 19, Case Study Part I—Design and Performance of Review Procedures* (product no. 154310 [online])
- *How to Perform a Review Under SSARS No. 19, Case Study Part II—Reporting and Other Communication Requirements* (product no. 154320 [online])
- *Advanced Compilation and Review Issues* (product no. 733386 [text])
- *Compilation and Review Engagement Essentials* (product no. 733883 [text])
- *Compilation Review Update—Compilation, Review, and Accounting Service Update* (product no. 733376 [text])
- *Compilation Engagements: Mastering the Fundamentals* (product no. 733627 [text])
- *Review Engagements: Mastering the Fundamentals* (product no. 733547 [text])
- *InSight: SSARS 19—The New Compilation and Review Standard* (product no. 154230LC [online])
- *Alternatives to GAAP: Using Special Purpose Frameworks* (product no. 734093 [text])

Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

.132 AICPA CPExpress, offered exclusively through CPA2Biz, is the AICPA's flagship online learning product. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. Some topics of special interest to those performing compilation and review engagements include the following:

- *Audit, Review & Compilation Reports*
- *Audit, Review & Compilation Reports: Engagement Reports*
- *Audit, Review & Compilation Reports: Managing Representation Letters*
- *Audit, Review & Compilation Reports: Practice Issues*
- *Audit, Review & Compilation Reports: Evaluating/Communicating Control Deficiencies*
- *Compilations and Reviews: Engagement Planning and Administration*
- *Compilation Engagements: Reporting*
- *Compilation Review Update: Current and Future Practice, Accounting, and Reporting Issues*
- *Compilations and Reviews: Independence Considerations*
- *Compilation Engagements: Introduction, Performing a Compilation and Other Compilation Engagements*
- *Compilations and Reviews: Introduction and Background*
- *Compilations and Reviews: 'Performing Compilation Engagements' plus 'Quality Control'*
- *Special Purpose Frameworks: Audit, Compilation, & Review; Procedures; AICPA's–FRF for SMEs™ Framework*
- *Review Engagements: Introduction plus Inquiry and Analytical Review Procedures*
- *Managing Compilation, Review, and Accounting Services*

To register or learn more, visit www.cpa2biz.com.

Webcasts

.133 Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality CPE programs that bring you the latest topics from the profession's leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived. For additional details on available webcasts, please visit www.cpa2biz.com/AST/AICPA_CPA2BIZ_Browse/Store/Webcasts.jsp.

Member Service Center

.134 To order AICPA products, receive information about AICPA activities, and get help with your membership questions, call the AICPA Service Operations Center at 888.777.7077.

Hotlines

Accounting and Auditing Technical Hotline

.135 Do you have a complex technical question about review, compilation, accounting, or other technical matters? If so, use the AICPA's Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. The hotline is available from 9 a.m. to 8 p.m. Eastern on weekdays. You can reach the Technical Hotline at 877.242.7212, by e-mail at aahotline@aicpa.org, or online at www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

Ethics Hotline

.136 In addition to the Technical Hotline, the AICPA also offers an Ethics Hotline. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. You can reach the Ethics Hotline at 888.777.7077 or by e-mail at ethics@aicpa.org.

AICPA Online Professional Library—Accounting and Auditing Literature

.137 The AICPA has created your core accounting and auditing library online. The AICPA Online Professional Library is now customizable to suit your preferences or your firm's needs. You can also sign up for access to the entire library. Get access—anytime, anywhere—to FASB ASC, the AICPA's latest *Professional Standards*, *Technical Practice Aids*, Audit and Accounting Guides, Audit Risk Alerts, *Accounting Trends & Techniques*, and more. To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

Financial Reporting Center of AICPA.org

.138 CPAs face unprecedented challenges in financial reporting. As such, the AICPA has created the Financial Reporting Center to support the execution of high quality financial reporting. This center provides exclusive member-only resources for the entire financial reporting process and can be accessed at www.aicpa.org/frc.

.139 The Financial Reporting Center provides timely and relevant news, guidance, and examples supporting the financial reporting process, including accounting; preparing financial statements and performing compilation and reviews, audit and attest, and assurance and advisory engagements.

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Appendix A—Illustrative Analytical Procedures for Review Engagements

> ***Note***: The following examples were reprinted from the AICPA Guide *Compilation and Review Engagements*, available from www.cpa2biz.com.

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 video gaming equipment. Because of recent legislation in several states that legalized slot machine gambling, 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 Gaming 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 demand for video gaming equipment due to recent legislation in several states that legalized slot machine gambling 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 video gaming equipment, 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 video gaming equipment is 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

Days sales in receivables

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.

Days sales in inventory

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.

Inventory turnover

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).

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.

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.

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.

<u>Sample documentation</u>

ABC Construction Contractors

Analytical Procedures

For the Year Ended December 31, 20XX

<u>Expectations</u>

- 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.

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Appendix B—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants who perform compilation and review engagements, as well as management of entities for whom such engagements are performed.

Website Name	***Content***	***Website***
AICPA	Summaries of professional standards as well as other AICPA activities.	www.aicpa.org www.cpa2biz.com www.ifrs.com
AICPA Accounting and Review Services Committee	Summaries of review and compilation standards and interpretations.	www.aicpa.org/Research/Standards/CompilationReview/ARSC/Pages/ARSC.aspx
AICPA Financial Reporting Center	Summaries of AICPA standard setting activity, recently issued technical Q&As, and financial reporting news. Links to other information related to accounting and financial reporting, audit and attest services, compilation services, review services, and assurance and advisory services.	www.aicpa.org/frc
AICPA Financial Reporting Executive Committee	AICPA technical committee for financial reporting. Its mission is to determine the AICPA's technical policies regarding financial reporting standards and to be the AICPA's spokesbody on those matters, with the ultimate purpose of serving the public interest by improving financial reporting.	www.aicpa.org/InterestAreas/frc/AccountingFinancialReporting/Pages/FinREC.aspx
AICPA Professional Ethics Executive Committee	AICPA technical committee charged with the responsibility of interpreting and enforcing the AICPA Code of Professional Conduct.	www.aicpa.org/InterestAreas/ProfessionalEthics/Pages/ProfessionalEthics.aspx

(continued)

Website Name	***Content***	***Website***
Economy.com	Source for analyses, data, forecasts, and information on the U.S. and world economies.	www.economy.com
The Federal Reserve Board	Source of key interest rates.	www.federalreserve.gov
Financial Accounting Standards Board (FASB)	Summaries of recent accounting pronouncements and other FASB activities.	www.fasb.org
Government Accountability Office	Policy and guidance materials and reports on federal agency major rules.	www.gao.gov
Governmental Accounting Standards Board (GASB)	Summaries of recent accounting pronouncements and other GASB activities.	www.gasb.org
International Accounting Standards Board	Summaries of International Financial Reporting Standards and International Accounting Standards.	www.iasb.org
International Auditing and Assurance Standards Board	Summaries of International Compilation and Review Standards.	www.iaasb.org
International Federation of Accountants	Information on standards setting activities in the international arena.	www.ifac.org
Private Company Financial Reporting Committee	Information on the initiative to further improve FASB's standard setting process to consider needs of private companies and their constituents of financial reporting.	www.pcfr.org
USA.gov	Portal through which all government agencies can be accessed.	www.usa.gov