2016

# Developments in preparation, compilation, and review engagements, 2016/17

American Institute of Certified Public Accountants (AICPA)

Developments in Preparation, Compilation, and Review Engagements

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# ALERT

STRENGTHENING AUDIT INTEGRITY | SAFEGUARDING FINANCIAL REPORTING

## 2016/17

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AICPA®

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# Notice to Readers

This 2016/17 edition of the AICPA Alert *Developments in Preparation, Compilation, and Review Engagements* (alert) replaces the AICPA Alert *Developments in Preparation, Compilation, and Review Engagements—2015/16*.

This alert is intended to provide accountants with an update on recent practice issues and professional standards that affect preparation, 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 preparation, compilation, and review publication, as defined in paragraph .07 of AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*). Other preparation, 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.

In applying the guidance included in an other preparation, 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 the accountant may presume that it is appropriate. Other preparation, compilation, and review publications that have not been reviewed by the AICPA Audit and Attest Standards staff that contradict an other preparation, compilation, and review publication that has been reviewed by the AICPA Audit and Attest Standards staff are inappropriate.

This document has not been approved, disapproved, or otherwise acted on by a senior committee of the AICPA.

## Recognition

**Reviewers**

AICPA Accounting and Review Services Committee
Mike Fleming, *Chair*

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.

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## Feedback

This alert 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 email these comments to A&APublications@aicpa.org.

 

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# How This Alert Helps You

**.01** This alert (alert) helps you plan and perform your preparation, compilation, and review engagements and can also be used by an entity's internal 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 pronouncements addressing preparation, compilation, and review engagements, as well as the full text of any rules or publications discussed in this alert. For developing issues that may have a significant impact on preparation, compilation, and review engagements in the near future, the "On the Horizon" section provides information on these topics, including guidance that either has been issued but is not yet effective or is in a developmental stage.

# Economic Developments

## The Current Economy

**.02** Economic conditions facing the industry in which an entity operates, such as 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 business and, therefore, its financial statements.

**.03** During 2015 and into 2016, the U.S. economy continued to recover. The S&P 500 and the Dow Jones Industrial Average both reached all-time highs during 2016. 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 continued to show an overall decline during the end of 2015 and into 2016. During that time, prices ranged from 31.40 to 11.43. 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 the end of 2015 and into 2016: 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 of America. It increases as the economy grows and decreases as it slows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 1.2 percent in the second quarter of 2016, based on the advance estimate (second estimate), and increased at an annual rate of 0.8 percent in the first quarter of 2016. The increase in real GDP in the second quarter has been attributed to positive contributions from personal consumption expenditures and exports that were partially offset by negative contributions from private inventory investment and residential fixed investments.

**.05** From July 2015 to July 2016, the unemployment rate fluctuated between 5.6 percent and 4.7 percent. A rate of 4.9 percent represents approximately 87.4 million people who are unemployed. According to the Bureau of Labor Statistics (BLS), from July 2015 to July 2016, the employment growth was 255,000 year over year. During that same time period, the number of long-term unemployed (those jobless for 27 weeks or more) was steady. According to the BLS, the number of people employed part-time for economic reasons decreased to 5.9 million during the second quarter of 2016. Together, these statistics illustrate the continued 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 remained through August 2015. In January 2016, the target was raised to 0.5 percent.

# Interpretation No. 1 to AR-C Section 90

## Considerations Related to Reviews Performed in Accordance With International Standard on Review Engagements 2400 (Revised)

**.07** In February 2016, the Accounting and Review Services Committee (ARSC) issued Interpretation No. 1, "Considerations Related to Reviews Performed in Accordance With International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to Review Historical Financial Statements," of AR-C section 90, *Review of Financial Statements* (AICPA, *Professional Standards*, AR-C sec. 9090 par. .01-.02). The interpretation provides guidance when a practitioner is engaged to perform a review in accordance with International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*. Although AR-C section 90 requires that the written review report include a statement that the accountant's responsibility is to conduct the review engagement in accordance with SSARSs, a practitioner may also indicate that the review was conducted in accordance with another set of review standards, such as ISRE 2400 (Revised), provided that the review was conducted in accordance with both sets of standards in their entirety. The interpretation also provides an illustrative report. The interpretation is included as an exhibit to this alert.

# Frequently Asked Questions and Answers From the Center for Plain English Accounting

**.08** The Center for Plain English Accounting (CPEA) is the AICPA's national audit and accounting resource center, available exclusively to members of the Private Companies Practice Section. The CPEA's team of experts assists member firms in understanding and implementing accounting, auditing, review, compilation, and quality control standards by sharing technical advice and guidance in a straight-forward manner. CPEA professional staff provide audit and accounting support by describing "how to do" what you "need to do" in implementing the authoritative literature.

**.09** CPEA regularly publishes reports and frequently asked questions and answers (FAQs) on the implementation of SSARSs, especially on questions and answers about the requirements for accountants engaged to prepare financial statements. To access this additional resource, please visit www.aicpa.org/CPEA.

 

## SSARS No. 22

**.10** In September 2016, ARSC issued SSARS No. 22, *Compilation of Pro Forma Financial Information* (AICPA, *Professional Standards*, AR-C sec. 120). SSARS No. 22 revises AR section 120, *Compilation of Pro Forma Financial Information* (AICPA, Professional Standards), by stating the requirements and guidance in clarity format. The clarified standards are designed to make the standards easier to read, understand, and apply. SSARS No. 22 can be accessed at www.aicpa.org/research/standards/compilationreview/downloadabledocuments/ssars_22.pdf.

**.11** The clarified standard will be codified as AR-C section 120 and is effective for compilation reports on pro forma financial information dated on or after May 1, 2017. Early implementation is permitted.

## SSARS No. 23

**.12** In October 2016, ARSC issued SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services—2016*. Although the primary revision to SSARSs as a result of the issuance of SSARS No. 23 is to have the standards apply to preparation and compilation of prospective financial information, SSARS No. 23 amends AR-C sections 60, 70, 80, and 90 as follows.

**.13** SSARS No. 23 amends AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* (AICPA, *Professional Standards*), to

- revise the applicability so that SSARSs applies to engagements performed on subject matter other than financial statements.
- include definitions of *financial statements* and *prospective financial information*; to harmonize the definitions of *engagement team* and *professional judgment* to that included in the clarified auditing standards; and to clarify the definition of *other preparation, compilation, and review publications*.
- include a mandatory requirement for the accountant to document the justification for a departure from a relevant presumptively mandatory requirement and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of the requirement.
- revise the requirement for the accountant to obtain the agreement of management that it acknowledges and understands its responsibility for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, so that the requirement does not apply if the accountant decides to accept responsibility for such internal control.

**.14** The revisions to AR-C section 60 were effective upon issuance.

**.15** SSARS No. 23 amends AR-C section 70, *Preparation of Financial Statements* (AICPA, *Professional Standards*), to

- expand the subject matter to which the section should be applied to include prospective financial information and to clarify (*a*) when the section applies, (*b*) when the section may be applied, and (*c*) when the section does not apply.

- clarify that the AICPA Guide *Prospective Financial Information* provides comprehensive guidance regarding prospective financial information, including suitable criteria for the preparation and presentation of prospective financial information, and that the accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria.

- clarify the nature of an engagement letter and to make clear that an oral understanding of the terms of the engagement is insufficient.

- clarify that when the accountant is unable to include a statement on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements that the accountant may withdraw from the engagement.

- include a requirement that because the summary of significant assumptions is essential to the users' understanding of prospective financial information, the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions or a financial projection that excludes either (*a*) an identification of the hypothetical assumptions or (*b*) a description of the limitations on the usefulness of the presentation.

**.16** The revisions to AR-C section 70 were effective upon issuance, with the exception of the revisions to paragraph .01 and new paragraphs .A1–.A2 (with respect to the expansion of the subject matter to which the section should be applied to include prospective financial information) and new paragraph .19 (with respect to the requirement that the accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions or a financial projection that excludes either [*a*] an identification of the hypothetical assumptions or [*b*] a description of the limitations on the usefulness of the presentation). Those revisions that were not effective upon issuance are effective for prospective financial information prepared on or after May 1, 2017. Early implementation is permitted.

**.17** SSARS No. 23 amends AR-C section 80, *Compilation Engagements* (AICPA, *Professional Standards*), to

- expand the subject matter to which the section should be applied to include prospective financial information, pro forma financial information, and other historical financial information.

- clarify that the AICPA Guide *Prospective Financial Information* provides comprehensive guidance regarding prospective financial information, including suitable criteria for the preparation and presentation of prospective financial information. Also, clarify that the accountant is not prohibited from performing a compilation engagement on prospective financial information prepared and presented in accordance with other suitable criteria.

 

- harmonize the definition of *misstatement* with that included in the clarified auditing standards.
- clarify the nature of an engagement letter and to make clear that an oral understanding of the terms of the engagement is insufficient.
- harmonize guidance with respect to the requirement that the accountant's compilation report include the signature of the accountant or the accountant's firm with that included in AR-C section 90 for an accountant's review report.
- include requirements when the accountant is issuing a compilation report on prospective financial information.
- clarify that the accountant is required to disclose known departures from the applicable financial reporting framework in the accountant's compilation report and that when the accountant becomes aware of a departure from the applicable financial reporting framework that is material to the financial statements and the financial statements are not revised, the accountant is required to consider whether modification of the standard report is adequate to disclose the departure.

**.18** The revisions to AR-C section 80 were effective upon issuance, with the exception of the revisions to paragraphs .01 and .A3 and new paragraphs .A1–.A2 and .A4 (with respect to the expansion of the subject matter to which the section should be applied to include prospective financial information), and paragraphs .24–.25 (to include requirements when the accountant is issuing a compilation report on prospective financial information), which are effective for compilation reports on prospective financial information dated on or after May 1, 2017. Early implementation is permitted.

**.19** SSARS No. 23 amends AR-C section 90 to

- clarify that AR-C section 90 applies to reviews of all historical financial information, excluding pro forma financial information.
- clarify the definition of *supplementary information.*
- clarify the nature of an engagement letter and to make clear that an oral understanding of the terms of the engagement is insufficient.
- revise the requirement that the engagement letter or other suitable form of written agreement be signed by (*a*) the accountant or the accountant's firm and (*b*) management or those charged with governance, as appropriate, to use language consistent with that used in corresponding paragraphs in AR-C sections 70 and 80.
- harmonize the requirement that the accountant's review report include the signature of the accountant or the accountant's firm with that included in AR-C section 80 for an accountant's compilation report.
- revise the accountant's reporting responsibilities when supplementary information accompanies reviewed financial statements and the accountant's review report thereon.

**.20** The revisions to AR-C section 90 were effective upon issuance.

# Recent AICPA Independence and Ethics Developments

## The Revised Code of Professional Conduct

**.21** A revised AICPA Code of Professional Conduct (the code) became effective on December 15, 2014. In an effort to make the code easier to use, it is available in a new and dynamic online platform accessible at http://pub.aicpa.org/codeofconduct. It is broken down into different parts by line of practice, is intuitively arranged by topic, and, where necessary, subtopic and section, and incorporates the conceptual framework approach, all while retaining the substance of the existing AICPA ethics standards. The new format allows for quick and easy navigation and also identifies when nonauthoritative content is available on a particular topic.

## AICPA Conceptual Frameworks

**.22** Aside from the format change, the most significant change is the incorporation of two conceptual frameworks, one for members in public practice and one for members in business. The conceptual framework approach, also known as the "threats and safeguards" approach, is a way of identifying, evaluating, and addressing threats that may exist and safeguards that may be applied to eliminate or reduce those threats to an acceptable level. The conceptual framework is used for areas where the code lacks guidance. This new section broadens the reach of the code by allowing members to reach conclusions even if specific guidance is not written in the code. These frameworks became effective on December 15, 2015.

### *AICPA Conceptual Frameworks Toolkits*

**.23** The AICPA developed conceptual framework toolkits for all three of the conceptual frameworks. The toolkits will assist members in understanding and applying the conceptual framework concepts to their specific situations. Specifically, the toolkits include the following:

- Steps of the conceptual framework to provide members with detailed guidance on what to do when applying the conceptual framework approach.
- A flowchart that serves as a visual aid for breaking down the steps of the conceptual framework approach.
- A worksheet to aid members with applying the steps of the conceptual framework. An example of how to use this worksheet is included in the toolkit.
- Examples of relationships or circumstances that are not addressed in the AICPA code and how the conceptual framework may be applied in such situations.

**.24** The toolkits are available at www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Pages/default.aspx.

## New and Revised Interpretations

### *New "Firm Mergers and Acquisitions" Interpretation*

**.25** A new interpretation was adopted that provides independence guidance when firms merge and one firm has relationships with attest clients of the other firm. The interpretation requires certain safeguards to be in place in order for independence to be maintained when a partner or professional employee of one firm is employed by or associated with an attest client of the other firm as a result of the merger or acquisition. Those safeguards include the following:

- Terminating relationship prior to the closing date
- Individual cannot participate on the attest engagement or be in position to influence the attest engagement
- Evaluate threats and apply safeguards
- Discuss with those charged with governance

**.26** The interpretation also provides guidance when one firm provided prohibited nonattest services to an attest client of the other firm. When it is the acquiring firm that provided services to the attest client of the acquired firm during the period covered by financial statements, the interpretation concludes that independence would be impaired. However, if the acquired firm provided services to the attest client of the acquiring firm, the firm may be able to evaluate threats and apply safeguards.

**.27** The interpretation is effective for mergers or acquisitions that close on or after January 31, 2016, and the complete text of the interpretation can be found at http://pub.aicpa.org/codeofconduct/resourceseamlesslogin.aspx?prod=ethics&tdoc=et-cod&tptr=et-cod1.220.040.

### *New "Transfer of Files and Return of Client Records in Sale, Transfer, Discontinuance, or Acquisition of a Practice" Interpretation*

**.28** At the July 2016 Professional Ethics Executive Committee (PEEC) meeting, a new interpretation was adopted that provides guidance on when a member sells, transfers, or discontinues all or part of his or her practice, and the member no longer retains ownership in or control of the practice. The interpretation calls for the member to take certain steps to notify his or her clients and maintain the confidentiality of any client files the member possesses. The interpretation also provides guidance to members who acquire a practice. Specifically, the member acquiring the practice should be satisfied that all clients of the predecessor firm subject to the acquisition have consented to the member's continuation of professional services and retention of any client files or records the successor firm retains.

**.29** The interpretation is effective June 30, 2017, with early implementation permitted. The new interpretation should be available in the online Code of Professional Conduct by October 2016 as an interpretation under the "Acts Discreditable Rule" (AICPA, *Professional Standards*, ET sec. 1.400.001). The numeric citation for this new interpretation will be ET section 1.400.205.

**.30** Staff plans to issue a couple of nonauthoritative FAQs on this issue. The FAQs will be available at www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf.

### *Revised "Disclosing Client Information in Connection With a Review or Acquisition of the Member's Practice" Interpretation*

**.31** An existing interpretation under the "Confidential Client Information Rule" (AICPA, *Professional Standards*, ET sec. 1.700.001) was expanded to provide guidance concerning a member's obligations to not disclose any confidential client information that is contained in files the member receives as a result of acquiring all or part of another member's professional practice.

## Proposed New Interpretation

### *Proposed New "Hosting Services" Interpretation*

**.32** A proposed new interpretation, the "Hosting Services" interpretation, was exposed for comment. The proposal, if adopted, would address situations in which a client engages a member to have custody or control of data or records that the client uses to conduct its operations. The proposal concludes that it is management's responsibility to have custody and control over its assets, so providing hosting services would create threats to independence that are not at an acceptable level and cannot be reduced to an acceptable level by the application of safeguards; therefore, independence is impaired. The proposal acknowledges that a member is not considered to be hosting an attest client's data or records when the member has access to, or copies of, such data or records and provides several examples, such as when a member provides a permitted nonattest service. Check the PEEC Exposure Drafts & Other Revisions to the Code of Professional Conduct page for updates on this exposure draft.

## New FAQs

**.33** In an effort to provide insight into how certain electronic tax records should be handled under the "Records Requests" interpretation, staff added three nonauthoritative FAQs under the topic "Electronic Records." They can be found online at www.aicpa.org/InterestAreas/ProfessionalEthics/Resources/Tools/DownloadableDocuments/Ethics-General-FAQs.pdf.

**.34** Staff also added an FAQ to this document to clarify that while a member may perform a professional service using standards that have not been established by a body designated by AICPA council (alternative standards), the member must consider whether the professional service can be covered by technical standards established by a body designated by AICPA council (established standards). If the service can be covered by established standards, the member must comply with both the alternative and established standards and is also reminded that irrespective of the standards that are complied with, the member must always comply with the "General Standards Rule" (AICPA, *Professional Standards*, ET sec. 1.300.001).

# Current Practice Issues

## Engaged vs. Engagement Letter

**.35** Paragraph .01 of AR-C section 70 states that the section applies "when an accountant in public practice is engaged to prepare financial statements or prospective financial information." Some accountants have expressed a level of confusion regarding when they are considered "engaged" to prepare financial statements.

**.36** Although *engaged* is not defined in SSARSs or the AICPA's Code of Professional Conduct, it refers to the action that commences the engagement to prepare financial statements. The accountant is "engaged" when the accountant and the entity mutually understand that the accountant has been hired to prepare the entity's financial statements. Such an engagement may be part of a broader service to provide accounting or bookkeeping services.

**.37** Paragraph .10 of AR-C section 70 requires that the accountant agree upon the terms of the engagement with management and document the agreed-upon terms of the engagement in an engagement letter or other suitable form of written agreement. There has been additional confusion about whether an accountant would be considered to have been "engaged" if they did not obtain an engagement letter. Being engaged starts the engagement process and, similar to a compilation, review, or audit engagement, obtaining a signed engagement letter or other suitable form of written agreement is the initial required engagement procedure and is intended to avoid misunderstandings with respect to the engagement.

## Preparation vs. Bookkeeping

**.38** Whether an engagement is a bookkeeping or accounting service or an engagement to prepare financial statements remains an area of confusion for practitioners. However, the determination is actually fairly easy. Although a level of professional judgment is necessary, the accountant has only been engaged to prepare financial statements if the client has "hired" the accountant to do so. If the accountant prepares financial statements as a by-product of another engagement (for example, although the client may have hired the accountant to prepare a tax return, the accountant may have prepared financial statements to facilitate the preparation of the tax return), the accountant was not engaged to prepare financial statements.

**.39** The agreement on the terms of the engagement with the client is vitally important. Although such an understanding and the subsequent documentation in an engagement letter is not required for accounting or bookkeeping services, accountants may find benefit in obtaining a signed engagement letter for all nonattest services. If it is the accountant's understanding that he or she is not engaged to prepare financial statements, the accountant may make that clear with a statement in the engagement letter, such as "This engagement does not contemplate us preparing financial statements."

## Independence Consideration

**.40** Although preparation services, like all other nonattest services, do not require the accountant to be independent to perform, practitioners are advised to be aware of possible independence impairments during the course of the engagement. This is important if the accountant believes that he or she may subsequently be engaged to perform an engagement requiring independence in the future. If independence is impaired as a result of the performance of the preparation or other nonattest service, the accountant cannot "cleanse themselves" prior to performing a compilation, review, or audit. In a situation in which an independent accountant is required, the client would need to hire another CPA firm to perform the service.

## Consideration of Going Concern in a Preparation, Compilation, or Review Engagement

**.41** Accounting principles generally accepted in the United States of America (GAAP) require that the preparer of financial statements

- perform an evaluation of the entity's ability to continue as a going concern for the period of one year after the date the financial statements are issued (or available to be issued).
- perform the evaluation every reporting period, including interim periods.
- include certain disclosures with respect to "close calls."
- include an explicit statement in the notes when there is substantial doubt and additional disclosures when substantial doubt is not alleviated.

**.42** The requirements are effective for calendar-year 2016 financial statements, and earlier application is permitted.

**.43** Accountants engaged to prepare financial statements in accordance with GAAP need to be aware of these requirements.

**.44** Accountants engaged to perform a compilation or a review of financial statements prepared in accordance with GAAP may become aware that the preparer of the financial statements may not have performed the required evaluation of the entity's ability to continue as a going concern or may not have included the required note disclosures. In such instances, the accountant should follow the requirements in paragraphs .29–.33 of AR-C section 80 and paragraphs .56–.60 of AR-C section 90 with respect to compilation and review engagements, respectively.

**.45** In addition, paragraphs .65–.68 of AR-C section 90 provide additional requirements with respect to the accountant's consideration of going concern in a review engagement.

**.46** Because financial statements prepared in accordance with the cash- and tax-basis financial statements should include informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the preceding applies to engagements on those financial statements as well.

## Subsequent Discovery of Fact

**.47** After issuance of the accountant's review report, the accountant may become aware of facts that, had the accountant known of such facts prior to the issuance of the report, may have caused the accountant to revise the report. Such facts are referred to as *subsequently discovered facts*.When the accountant becomes aware of subsequently discovered facts, he or she is required to perform certain procedures. Management's response to the subsequently discovered fact may reveal that the financial statements, including related notes, may require adjustment, the report may need to be withdrawn and reissued, users may need to be notified, and the practitioner may need to consider ending the client relationship.

**.48** Paragraphs .71–.73 of AR-C section 90 provides requirements when subsequently discovered facts become known to the accountant before the report release date. In summary, the accountant is required to

- discuss the matter with management and, when appropriate, those charged with governance and

 

- determine whether the financial statements need revision and, if so, inquire how management intends to address the matter in the financial statements.

**.49** If management revises the financial statements, the accountant is required to perform the review procedures necessary in the circumstances on the revision. The accountant also is required to either (*a*) date the accountant's review report as of a later date or (*b*) include an additional date in the accountant's review report on the revised financial statements that is limited to the revision (that is, dual-date the accountant's review report for that revision), thereby indicating that the accountant's review procedures subsequent to the original date of the accountant's review report are limited solely to the revision of the financial statements described in the relevant note to the financial statements.

**.50** If management does not revise the financial statements in circumstances when the accountant believes they need to be revised, the accountant is required to modify the accountant's review report, as appropriate.

**.51** Paragraphs .74–.77 of AR-C section 90 provides requirements when subsequently discovered facts become known to the accountant after the report release date. In summary, the accountant is required to

- discuss the matter with client management (and when appropriate, those charged with governance).
- determine whether the financial statements require revision and, if so, inquire how management intends to address the matter in the financial statements.
- if management revises the financial statements
    - — perform the review procedures necessary in the circumstances on the revisions.
    - — if reviewed financial statements (before revision) have been made available to third parties, assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of those financial statements is informed of the situation, including that the reviewed financial statements are not to be used.
    - — if the accountant's conclusion on the revised financial statements differs from the accountant's conclusion on the original financial statements, disclose in an emphasis-of-matter paragraph (*a*) the date of the accountant's previous report, (*b*) a description of the revisions, and (*c*) the substantive reasons for the revisions.
- if management does not revise the financial statements in circumstances when the accountant believes they need to be revised, then
    - — if the reviewed financial statements have not been made available to third parties, the accountant should notify management and those charged with governance, unless all of those charged with governance are involved in managing the entity, not to make the reviewed financial statements available to third parties before the necessary revisions have been made and a new accountant's review

report on the revised financial statements has been provided.

— if the reviewed financial statements have been made available to third parties, the accountant should assess whether the steps taken by management are timely and appropriate to ensure that anyone in receipt of the reviewed financial statements is informed of the situation, including that the reviewed financial statements are not to be used.

- if management does not take the necessary steps to ensure that anyone in receipt of the financial statements is informed of the situation, the accountant is required to notify management and those charged with governance that the accountant will seek to prevent future use of the accountant's review report. If, despite such notification, management or those charged with governance do not take the necessary steps, the accountant is required to take appropriate action to seek to prevent use of the accountant's review report. The accountant may consider it necessary to seek legal advice.

## Detection of Theft or Fraud in a Preparation, Compilation, or Review Engagement

**.52** The following section was taken from the article "Failure to Detect Theft or Fraud: It's not just an audit issue," by Sarah Beckett Ference, CPA. Ms. Ference is a Risk Control Director at CNA and oversees risk control services provided to CPA firms in the AICPA Accountants Professional Liability Insurance Program. The AICPA thanks her for her assistance and for providing guidance to our members. This article was originally published in the February 2014 issue of the *Journal of Accountancy* and was modified to focus on SSARSs engagements.

> Commonly referred to as the "expectation gap," a disconnect sometimes exists between a CPA's professional responsibility for detecting theft and fraud and the general public's perception of a CPA's duties. AICPA *Statement on Standards for Accounting and Review Services* No. 21 (SSARS No. 21) for review services includes a responsibility to inform the appropriate levels of management if any information or evidence comes to the CPA's attention indicating a fraud may have occurred. While a similar requirement does not exist in SSARS No. 21 for compilation and preparation services, claims made against CPA firms in the AICPA Professional Liability Insurance Program alleging failure to detect theft and fraud have emanated from services generally regarded by CPAs as lower-risk, such as compilation services and even bookkeeping or tax compliance services.
>
> In such cases, plaintiff attorneys may contend that the CPA failed to exercise due care in accordance with Article V of the Principles of Professional Conduct, which are included in the AICPA Code of Professional Conduct. Lawyers may allege that CPAs have a duty to identify and inform clients of fraud red flags such as suspicious activities or significant internal control deficiencies. While adherence to professional standards assists CPAs in defending these types of claims, there is no guarantee that such a defense will be successful.

CPAs may believe that longtime clients would never assert such a claim against them. However, a congenial working relationship can take an abrupt turn when fraud is discovered. Clients then may question why a CPA didn't discover the fraud earlier or bring matters to the client's attention that could have prevented it.

To illustrate how a CPA can get tangled up in a client's fraud, consider the following scenarios based on real-life claims:

> Scenario 1. A CPA was engaged to perform tax compliance, tax planning, bookkeeping, and preparation services for a recruiting agency. To understand potential year-end tax implications, the CPA summarized select income and payables accounts and discussed trends with the owner. The CPA also received monthly bank statements and prepared bank reconciliations. The controller, a long-time employee of the agency, embezzled more than $1 million by writing checks to himself, reporting them as business expenses, and destroying the canceled checks (or scanned copies of them) when the bank statements were received.
>
> The owner brought a claim against the CPA for failing to detect the embezzlement. Expert review of the engagement noted that the controller had unmonitored access and responsibilities in accounts payable and that the trend analysis the CPA performed noted unusual fluctuations in expense accounts. The plaintiff's attorney argued that the CPA should have identified the trend fluctuations as a red flag and brought this and the internal control weakness to the owner's attention for further investigation.
>
> Scenario 2. A CPA firm compiled annual financial statements for a local wine producer. The firm sued the client for outstanding fees, and the client countersued, alleging failure to detect a high six-figure embezzlement perpetrated by three of its employees, all of whom colluded to create false wire transfers and payroll checks. The CPA firm's invoices, which were produced during the lawsuit's discovery phase, indicated that the firm performed a review of financial statements, made changes in financial statement classifications and general ledger adjustments, and completed bank reconciliations. CPA firm representatives also worked extensively on-site with the employee/embezzlers and were involved in the company's day-to-day financial operations, but they did not discover the fraudulent wire transfers or payroll checks.

**LIMITING RISK EXPOSURES**

CPAs can use several techniques to protect themselves against risk exposures related to failure to detect theft and fraud. They include:

- Regularly evaluate the risk of the client and the engagement. Client and engagement acceptance and continuance protocols are not simply for audit engagements. Regularly screen clients and consider the risks associated with both the client and the services you are being engaged to perform. It should raise a red flag for the CPA when clients dismiss internal control weaknesses brought to their attention. Is this a situation where the client has an unreasonable service expectation, or is it possibly one of questionable integrity? Either way, the CPA should take precautions.

- Use engagement letters on all engagements. Even though SSARS No. 21 now requires an engagement letter or other suitable form of written agreement for review, compilation, and preparation services, claim experiences of the AICPA Professional Liability Insurance Program has indicated there is room for improvement. A well-crafted engagement letter can help reduce expectation gaps and can serve as key evidence in the defense of a professional liability claim. The engagement letter should include an understandable description of the scope and limitation of services to be performed, a statement that the engagement is not designed to detect theft or fraud, and the responsibilities of both the client and the CPA. The engagement letter should also be renewed and signed by the client annually.
- Stay within the scope of the engagement. An engagement letter is useful only if the CPA adheres to the defined scope in rendering the professional services. Additional services, or modifications to agreed-upon services, should be memorialized in writing with the client, whether it's through email, a new engagement letter, or an amendment to the existing engagement letter.
- Be fraud aware. Train all firm personnel, not only auditors, about potential fraud risk factors and the "fraud risk triangle" (opportunity, rationalization, and incentive/pressure). Learn about the risk factors associated with common frauds, such as embezzlement by an unmonitored bookkeeper or controller with excessive authority or access, or use of business credit cards for personal expenses. Firm personnel should be educated about common internal control weaknesses that create an opportunity for fraud to occur, such as a lack of segregation of duties, poor tone at the top, or infrequent vacations taken by key financial employees.
- Apply professional skepticism to all engagements. This is particularly important on engagements with long-time clients, where a level of established comfort could threaten objectivity. Trust your instincts and follow up on matters that don't seem quite right.
- If you see something, say something, and follow up in writing. Management letters with suggestions for control or process improvements are not designed solely for audit clients. If you observe a weakness in internal controls or believe management should follow up on an observation noted, inform your client orally and in writing. If the weakness persists year after year, keep telling the client both orally and in writing until the deficiency is addressed.

 

- Document, document, document. Contemporaneous documentation represents critical evidence in the defense of professional liability claims. Strong documentation includes, at a minimum, a well-crafted and detailed engagement letter, documentation regarding client inquiries made and responses received, and communication of internal control matters or suspicious activities noted. Without documentation, many juries are more sympathetic to the client. Documentation provides defense counsel something to defend.

# Peer Reviews of Compilation and Review Engagements

## Matters for Consideration

**.53** 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, or both. A matter is noted as a result of evaluating whether an engagement submitted for review was performed or reported on in accordance with applicable professional standards, or both. The evaluation includes reading the financial statements or information and the related accountant's reports and assessing the adequacy of procedures performed, including related documentation.

**.54** Depending on the resolution of a matter and the process of aggregating and evaluating peer review results, a matter may develop into a finding, deficiency, or significant deficiency.

**.55** The AICPA Peer Review Program collects data during peer reviews to learn about trouble spots and is developing resources within the AICPA that will allow firms to have a more focused remedy for their findings. Based on peer reviews of engagements with year-ends between December 31, 2014 and March 31, 2016, the items that follow were common examples of noncompliance (both material and immaterial) with professional standards. Most of the identified items are the same as last year. These items are updated quarterly and can be found at www.aicpa.org.

### *Reviews*

**.56** Below is a summary of peer review findings related to review engagements:

- Failure to obtain appropriate management representation letters. Matters included failure to
  - — include all representations required by the applicable professional standards.
  - — date the letter appropriately.
  - — include appropriate financial statement periods.
- Failure to prepare reports in accordance with current standards
- Failure to obtain an engagement letter or failure to have all the required elements included within the engagement letter

- Failure to report the degree of responsibility taken with respect to supplementary information presented with the financial statements and the accountant's review report thereon
- Failure to document expectations or the comparison of expectations to recorded amounts for analytical procedures

### *Compilations*

**.57** Below is a summary of peer review findings related to compilation engagements:

- Failure to prepare reports in accordance with professional standards. The following matters were noted:
  - Not updated for current standards
  - No explanation of the degree of responsibility the accountant is taking with respect to supplementary information that accompanies the financial statements and the accountant's compilation report thereon
  - Failure to mention that substantially all disclosures are omitted
- Failure to obtain an engagement letter or failure to include all required elements (for example, objectives of the engagement) required by SSARSs.

## Common Peer Review Findings—Review Engagements

**.58** The following headings represent the broad findings based on the data collected from the AICPA Peer Review Program, and the text within the following sections discusses the proper treatment in accordance with AR-C section 90.

### *Management Representations—Omissions and Errors*

**.59** Paragraphs .32–.37 of AR-C section 90 provide the requirements with respect to written representations in a review engagement. Written representations from management are required for all financial statements presented and periods covered by the accountant's review. The accountant should request that management provide written representations that are dated as of the date of the accountant's review report stating

- that management has fulfilled its responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, as set out in the terms of the engagement.
- that management acknowledges its responsibility for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of financial statements, including its responsibility to prevent and detect fraud.
- that management has provided the accountant with all relevant information and access, as agreed upon in the terms of the engagement.
- that management has responded fully and truthfully to all of the accountant's inquiries.

- that all transactions have been recorded and are reflected in the financial statements.
- that management has disclosed to the accountant its knowledge of fraud or suspected fraud affecting the entity involving
  - — management,
  - — employees who have significant roles in internal control, or
  - — others when the fraud could have a material effect on the financial statements.
- that management has disclosed to the accountant its knowledge of any allegations of fraud or suspected fraud affecting the entity's financial statements communicated by employees, former employees, regulators, or others.
- that management has disclosed to the accountant all known instances of noncompliance or suspected noncompliance with laws and regulations, whose effects should be considered when preparing financial statements.
- whether management believes that the effects of uncorrected misstatements are immaterial, individually and in the aggregate, to the financial statements as a whole. A summary of such items should be included in, or attached to, the written representation.
- that management has disclosed to the accountant all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements, and it has appropriately accounted for and disclosed such litigation and claims in accordance with the applicable financial reporting framework.
- whether management believes that significant assumptions they use in making accounting estimates are reasonable.
- that management has disclosed to the accountant the identity of the entity's related parties and all of the related party relationships and transactions of which it is aware, and it has appropriately accounted for and disclosed such relationships and transactions.
- that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

**.60** 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*

**.61** Practitioners should note that financial statements reviewed by the accountant should be accompanied by a written report. The basic review reporting requirements are included in paragraphs .38–.39 of AR-C section 90. The basic elements of the report are as follows:

- Title
- Addressee

- Introductory paragraph
- Management's responsibility for the financial statements
- Accountant's responsibility
- Accountant's conclusion
- Signature of the accountant
- The city and state where the accountant practices
- Date of the accountant's report

### *Supplementary Information—Failure to Report the Degree of Responsibility Taken With Respect to Supplementary Information*

**.62** Paragraphs .80–.82 of AR-C section 90 provide the requirements with respect to supplementary information that accompanies reviewed financial statements and the accountant's review thereon. When supplementary information accompanies financial statements and the accountant's review report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either an other-matter paragraph in the accountant's review report or in a separate report on the supplementary information.

### *Engagement Letters—Omissions and Errors*

**.63** Please see the "Current Practice Issues" section in this alert for information on engagement letters.

### *Review Documentation—Failure to Document Expectations or the Comparison of Expectations to Recorded Amounts for Analytical Procedures*

**.64** Paragraphs .19–.20 of AR-C section 90 provide requirements with respect to designing and performing analytical procedures in a review engagement. The results of the analytical procedures allow the accountant to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and may indicate a material misstatement. Such analytical procedures should include the following:

*a.* Comparing the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions

*b.* Considering plausible relationships among both financial and, when relevant, nonfinancial information

*c.* Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant through identifying and using relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates

*d.* Comparing disaggregated revenue data, as applicable

**.65** When designing and performing analytical procedures, the accountant should

*a.* determine the suitability of particular analytical procedures;

 

*b.* consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of information available;

*c.* develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and

*d.* determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and compare the recorded amounts, or ratios developed from recorded amounts, with the expectations.

**.66** Paragraph .91 of AR-C section 90 requires the accountant to prepare review documentation that is sufficient to enable an experienced accountant having no previous connection to the review to understand the procedures performed by the accountant to comply with the requirements regarding analytical procedures, as mentioned previously.

## Common Peer Review Findings—Compilation Engagements

**.67** The following headings represent the broad findings based on the data collected from the AICPA Peer Review Program, and the text within the following sections discusses the proper treatment of MFC forms in accordance with AR-C section 80.

### *Reporting on the Financial Statements—Failure to Prepare Reports in Accordance With Professional Standards*

**.68** Paragraphs .18–.21 of AR-C section 80 provide the requirements for the basic accountant's compilation report. The accountant's compilation report should be in writing and should

- include a statement that management (owners) is (are) responsible for the financial statements.
- identify the financial statements that have been subjected to the compilation engagement.
- identify the entity whose financial statements have been subjected to the compilation engagement.
- specify the date or period covered by the financial statements.
- include a statement that the accountant performed the compilation engagement in accordance with SSARSs promulgated by the Accounting and Review Services Committee of the AICPA.
- include a statement that the accountant did not audit or review the financial statements nor was the accountant required to perform any procedures to verify the accuracy or completeness of the information provided by management and, accordingly, does not express an opinion, a conclusion, nor provide any assurance on the financial statements.

- include the signature of the accountant or the accountant's firm.
- include the city and state where the accountant practices.
- include the date of the report, which should be the date that the accountant has completed the procedures required by AR-C section 80.

### *Supplementary Information—No Explanation of the Degree of Responsibility the Accountant Is Taking With Respect to Supplementary Information*

**.69** Paragraphs .34–.36 of AR-C section 80 provide the requirements with respect to supplementary information that accompanies financial statements and the accountant's compilation report thereon. When supplementary information accompanies financial statements and the accountant's compilation report thereon, the accountant should clearly indicate the degree of responsibility, if any, the accountant is taking with respect to such information in either a separate paragraph in the accountant's compilation report or in a separate report on the supplementary information.

### *Reporting on the Financial Statements—Failure to Report That Substantially All Required Disclosures Have Been Omitted*

**.70** In accordance with paragraph .27 of AR-C section 80, when reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should include a separate paragraph in the accountant's compilation report that includes the following elements:

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

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

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

### *Engagement Letters—Omissions and Errors*

**.71** Readers should refer to the section "Current Practice Issues" in this alert for information on engagement letters.

► AICPA Peer Review Program: Training and frequently asked questions about the AICPA Peer Review program can be found at www.aicpa.org. Questions can also be directed to the Peer Review Hotline at 919.402.4502 or prptechnical@aicpa.org.

 

## Recent Activities of FASB's Private Company Council

**.72** 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. The PCC will develop, deliberate, and formally vote on proposed alternatives for private companies within U.S. GAAP. FASB and the PCC will also consider private company issues in standard-setting projects under active consideration on FASB's technical agenda.

### Intangibles, Business Combination, Consolidation, Derivatives, and Hedging

**.73** In March 2016, FASB issued Accounting Standards Update (ASU) No. 2016-03, *Intangibles—Goodwill and Other (Topic 350), Business Combinations (Topic 805), Consolidation (Topic 810), Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance (a consensus of the Private Company Council)*. According to this ASU, the PCC added this issue to its agenda in response to concerns raised by private company stakeholders about the required assessment of preferability when electing a private company accounting alternative for the first time after its effective date. The PCC also added this issue to its agenda to address concerns raised by private company stakeholders about transition guidance in ASU No. 2014-02, *Intangibles—Goodwill and Other (Topic 350): Accounting for Goodwill (a consensus of the Private Company Council)*, and ASU No. 2014-03, *Derivatives and Hedging (Topic 815): Accounting for Certain Receive-Variable, Pay-Fixed Interest Rate Swaps—Simplified Hedge Accounting Approach (a consensus of the Private Company Council*).

**.74** The amendments in this ASU make the guidance in ASU Nos. 2014-02, 2014-03, 2014-07, and 2014-18 effective immediately by removing their effective dates. The amendments also include transition provisions that provide that private companies are able to forgo a preferability assessment the first time they elect the accounting alternatives within the scope of this ASU. Any subsequent change to an accounting policy election requires justification that the change is preferable under FASB ASC 250, *Accounting Changes and Error Corrections*.

**.75** The amendments in this ASU also extend indefinitely the transition guidance in ASU Nos. 2014-02, 2014-03, 2014-07, and 2014-18. Although this ASU extends transition guidance for ASU Nos. 2014-07 and 2014-18, there is no intention to change how transition is applied for those two ASUs.

## Other FASB Activities

### Leases

**.76** In February 2016, FASB issued ASU No. 2016-02, *Leases (Topic 842)*, effective for fiscal years of a public business entity; a not-for-profit entity that has issued, or is a conduit bond obligor for, securities that are traded, listed, or quoted on an exchange or an over-the-counter market; and an employee benefit plan that files financial statements with the SEC beginning after December 15, 2018, including interim periods within those fiscal years.

 

**.77** For all other entities, ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2019.

**.78** Early application is permitted for all entities.

**.79** ASU No. 2016-02 supersedes the lease requirements in FASB *Accounting Standards Codification* (ASC) 840, *Leases*, and creates FASB ASC 842, *Leases*, to establish the principles that lessees and lessors should apply to report useful information to users of financial statements about the amount, timing, and uncertainty of cash flows arising from a lease. FASB ASC 842 affects any entity that enters into a *lease* (as that term is defined in ASU No. 2016-02), with some specified scope exceptions. The objective of the ASU is to increase transparency and comparability in financial reporting by requiring balance sheet recognition of leases and note disclosure of certain information about lease arrangements.

## Revenue Recognition Standards

**.80** On May 28, 2014, the International Accounting Standards Board (IASB) and FASB issued a joint accounting standard on revenue recognition to address a number of concerns regarding the complexity and lack of consistency surrounding the accounting for revenue transactions. Consistent with each board's policy, FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, and the IASB issued International Financial Reporting Standard (IFRS) 15, *Revenue from Contracts with Customers*. ASU No. 2014-09 will amend the FASB ASC by creating a new Topic 606, *Revenue from Contracts with Customers*, and a new subtopic 340-40, *Other Assets and Deferred Costs—Contracts with Customers*. The guidance in ASU No. 2014-09 provides what FASB describes as a framework for revenue recognition and supersedes or amends several of the revenue recognition requirements in FASB ASC 605, *Revenue Recognition*, as well as guidance within the 900 series of industry-specific topics.

**.81** As part of the boards' efforts to converge U.S. GAAP and IFRSs, the standard eliminates the transaction- and industry-specific revenue recognition guidance under current GAAP and replaces it with a principles-based approach for revenue recognition. The intent is to avoid inconsistencies of accounting treatment across different geographies and industries. In addition to improving comparability of revenue recognition practices, the new guidance provides more useful information to financial statement users through enhanced disclosure requirements. FASB and the IASB have essentially achieved convergence with these standards, with some minor differences related to the collectibility threshold, interim disclosure requirements, early application and effective date, impairment loss reversal, and nonpublic entity requirements.

**.82** The standard applies to any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets, unless those contracts are within the scope of other standards (for example, insurance or lease contracts).

**.83** On August 12, 2015, FASB issued ASU No. 2015-14, *Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date*, to allow entities additional time to implement systems, gather data, and resolve implementation questions. This update allows for public business entities, certain not-for-profits, and certain employee benefit plans to apply the new requirements to annual reporting periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Earlier application is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period.

**.84** All other entities will now apply the guidance in ASU No. 2014-09 to annual reporting periods beginning after December 15, 2018, and interim reporting periods within annual reporting periods beginning after December 15, 2019. Application is permitted earlier only as of an annual reporting period beginning after December 15, 2016, including interim reporting periods within that reporting period, or an annual reporting period beginning after December 15, 2016, and interim reporting periods within annual reporting periods beginning one year after the annual reporting period in which an entity first applies the guidance in ASU No. 2014-09.

**.85** The core principle of the revised revenue recognition standard is that an entity should recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those good or services.

**.86** To apply the proposed revenue recognition standard, ASU No. 2014-09 states that an entity should follow these five steps:

1. Identify the contract(s) with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

**.87** Under the new standard, revenue is recognized when a company satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). See the following discussion of the five steps involved when recognizing revenue under the new guidance.

## Financial Instruments

**.88** On January 5, 2016, FASB issued ASU No. 2016-01, *Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*, to enhance the reporting model for financial instruments and to provide users of financial statements with more decision-useful information. The amendments in the ASU are intended to improve certain aspects of recognition, measurement, presentation, and disclosure of financial instruments.

**.89** The new guidance will accomplish the following:

- Require equity investments (except those accounted for under the equity method of accounting or those that result in consolidation of the investee) to be measured at fair value with changes in fair value recognized in net income.
- Replace the impairment model for equity investments without readily determinable fair values with a qualitative impairment assessment.

- Eliminate the requirement to disclose the fair values of financial assets and financial liabilities measured at amortized cost for entities that are not public business entities.
- Eliminate the requirement for public business entities to disclose the methods and significant assumptions used to estimate fair value that is required to be disclosed for financial assets and financial liabilities measured at amortized cost on the balance sheet.
- Require public business entities to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes.
- Require an entity to present separately in other comprehensive income the portion of the total change in the fair value of a liability resulting from a change in instrument-specific credit risk when the entity has elected to measure the liability at fair value in accordance with the fair value option for financial instruments.
- Require separate presentation of financial assets and financial liabilities by measurement category and form of financial asset (that is, securities or loans and receivables) on the balance sheet or the accompanying notes to the financial statements.
- Clarify that an entity should evaluate the need for a valuation allowance on a deferred tax asset related to available-for-sale debt securities in combination with an entity's other deferred tax assets.
- Eliminate an entity's ability to estimate the disclosed fair values of financial assets and financial liabilities on the basis of entry prices.

**.90** For details of applicability and the effective date of this ASU, please refer to www.fasb.org.

## On the Horizon

**.91** This alert identifies certain developments and standard-setting activities that are of particular importance to preparation, compilation, and review engagements. The following sections present brief information about some ongoing projects that have particular significance to preparation, compilation, and review engagements. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

**.92** 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. Many more accounting and auditing projects exist in addition to those discussed here. Readers may refer to the Audit Risk Alert *General Accounting and Auditing Developments—2016/17* (product nos. ARAGEN16P, ARAGEN16E, or WGE-XX), for further information.

### Using the Work of Other Accountants and International Financial Reporting Issues

**.93** Subsequent to the issuance of SSARS No. 21, certain practice issues were identified that accountants may encounter with respect to using the work of other accountants as well as international compilation and review standards or international accounting standards. ARSC is considering certain revisions to AR-C section 90 to provide requirements and guidance in those situations. If passed as a final standard, the proposed SSARS would revise AR-C section 90 to

- provide requirements and guidance when financial statements are prepared in accordance with a financial reporting framework generally accepted in another country.
- provide requirements when a review is performed in accordance with both SSARSs and another set of review standards.
- preclude the accountant from referencing, in the accountant's review report, the review or audit report of other accountants if such accountant's report is restricted as to use.
- provide guidance when the accountant decides to make reference to the review or audit of other accountants of financial statements of a significant component and the other accountant's review or audit is performed in accordance with standards other than SSARSs or GAAS.
- provide review reporting requirements and guidance when the accountant decides to make reference to the review or audit of other accountants who review or audit the financial statements of a significant component, which are prepared using a different financial reporting framework from that used for the financial statements of the reporting entity.

**.94** ARSC plans to consider the draft standard at its meeting in November 2016 and vote on whether to expose the proposed SSARS for public comment. If ARSC votes to expose the proposed SSARS for public comment, it will be exposed in December 2016 with a comment period ending in mid- to late April 2017. ARSC would then consider comments received on the exposure draft at its meeting in May 2017.

## Specified Procedures

**.95** ARSC and the Auditing Standards Board (ASB) have commenced a project to jointly develop a standard that would result in a new service in which CPAs would perform procedures and report on the results of those procedures—without being required to request or obtain an assertion from the engaging party or restrict the use of the report.

**.96** The proposed standard

- will be engagement driven;
- will not include a requirement to request or obtain an assertion;
- would require that the accountant report in a manner resembling an agreed-upon procedures report in that it would present procedures and related findings; and
- would not require a restricted use report.

**.97** The proposed standard would address issues such as the following:

- Engaging party may not be in a position to make an assertion (for example, engaging party may not be the responsible party).

- It may not be possible or appropriate for the engaging party to perform the initial measurement (for example, balloting, union election, lottery, or benchmarking services, or the engaging party does not have the appropriate skills or knowledge).
- All users may not have the same objective or be able to agree to the sufficiency of the procedures (for example, government limitations or use of the report varies by user).
- The CPA may not know what procedures to perform prior to commencement of the engagement.
- The report is restricted for use, and there is a need for a general use report.

**.98** The practitioner's report on specified procedures may be beneficial to and used by a broad number of parties (for example, customers) as opposed to being restricted to just specified parties that provide acknowledgement of the sufficiency of the procedures. Each user of the specified procedures report would make his or her own determination on how the report is to be used and relied upon based upon the procedures performed and the results of the procedures.

**.99** Examples of situations in which a specified procedures service may be performed include the following:

- A company wants a report on a measurement of progress on an initiative such as the following:
  - — Areas prior to obtaining examination level of assurance. Not waiting until the comprehensive criteria are fully met, but measuring progress and communicating interim thresholds and goals to the market, that is, procedures and the results of procedures.
  - — Procedures and findings that specific divisions and operating units are making towards a company's established set of criteria (for example, minority hiring goals) that may be distributed to all employees.
  - — Progress to employees (for example, maybe certain performance or quality metrics).
- A company wants to evaluate suppliers. Specified procedures would go to both supplier (responsible party) and company (engaging party). Reports may be made available to the greater market.
- A company has a known "market issue" (for example, cyber breach, regulatory violation or order, product reputation failure) and wants a practitioner to perform certain procedures and report to their customer base.
- Internal audit outsourcing.

**.100** It is anticipated that ARSC and the ASB will vote to expose a proposed standard for public comment during 2017.

## Upcoming ARSC Meetings

**.101** The following dates represent future scheduled public ARSC meetings:

 

- November 15–17, 2016—San Antonio, TX
- January 17–19, 2017—Key West, FL
- May 9–11, 2017—Indianapolis, IN

**.102** Please note that the schedule is subject to change. Observers are welcome to attend the meetings. To register to attend a meeting, please complete and submit the form at www.aicpa.org/Research/Standards/CompilationReview/ARSC/Pages/arsc-meeting-observer-registration.aspx.

## Resource Central

**.103** The following are various resources that practitioners and accounting professionals may find beneficial.

### Publications

**.104** Practitioners and accounting professionals may find the following publications useful. Choose the format best for you—online, e-book, or print.

- *Codification of Statements on Standards for Accounting and Review Services* (product no. ACODSSARS16P [paperback] or ACODSSARS16E [e-book])
- AICPA Practice Aid *Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements* (product no. APACTB15P [paperback], APACTBO [online], or APACTB15E [e-book])
- AICPA Guide *Preparation, Compilation, and Review Engagements (2016)*, (product no. AAGCRV16P [paperback], AAGCRV16E [e-book], WRC-XX [online])
- *U.S. GAAP Financial Statements—Best Practices in Presentation and Disclosure (formerly Accounting Trends & Techniques)* (product no. ATTATT16P [paperback] or ABPPDO [online])
- *Financial Reporting Framework for Small- and Medium-Sized Entities with Implementation Resources* (product no. AFRFSME13E [e-book] or AFRFSMEO [online])

### The Engagement Letter: Best Practices and Examples

**.105** *The Engagement Letter: Best Practices and Examples* tool provides guidance on developing engagement letters in accordance with applicable AICPA professional standards. Offered in a convenient and efficient online format, subscribers to this tool can download the sample engagement letters for easy mark up and customization.

### FRF for SMEs Toolkits

**.106** The AICPA has developed free FRF for SMEs[a] 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.

**.107** All of the resources are available free of charge at www.aicpa.org/frc.

## Decision Tool for Adopting FRF for SMEs

**.108** 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. Readers should note that the tool is presented as a nonauthoritative aid, and its use is not required. The tool is available online to AICPA members at the AICPA's Financial Reporting Center (FRC) at www.aicpa.org/frc.

## Continuing Professional Education

### *Self-Study Print CPE*

**.109** 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 specifically related to engagements performed in accordance with SSARSs:

- *Engagement Essentials: Preparation of Financial Statements* (product no. 733530[text])
- *Engagement Essentials: Review of Financial Statements* (product no. 733549 [text])
- *Engagement Essentials: Preparation, Compilation, and Review of Financial Statements* (product no. 746101)
- *Preparation, Compilation, and Review Engagements Update* (product no. 163462 [CPE On-Demand])
- *Annual Update for Preparation, Compilation, and Review Engagements* (product no. 746062 [text], 163932 [CPE On-Demand])

**.110** Visit www.AICPAStore.com for a complete list of CPE courses.

### *Online CPE*

#### *CPExpress*

**.111** AICPA CPExpress, offered exclusively through the AICPA store, 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. Subscriptions are available at www.AICPAStore.com.

#### *Online Curriculum*

**.112** *Preparation, Compilation, and Review Staff Essentials* is a new curriculum that has been designed to provide a convenient, accessible way for firms to train their staff on how to perform preparation, compilation, and review engagements. This curriculum combines real-world examples, practice exercises, case studies, and a learning coach to create a flexible, engaging learning experience. The full curriculum comprises 9 courses that total 17 hours of CPE credit. There are also two series in the curriculum: the Review Engagements

Series and the Compilation and Preparation Engagements Series. Each of the 9 courses can also be purchased individually. Visit www.AICPAStore.com for the full curriculum description.

### *Webcasts*

**.113** 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.AICPAStore.com.

## Member Service Center

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

## Hotlines

### *Accounting and Auditing Technical Hotline*

**.115** Do you have a complex technical question about reviews, compilations, and engagements to prepare financial statements 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. ET on weekdays. You can reach the Technical Hotline at 877.242.7212 or online at www.aicpa.org/Research/TechnicalHotline/Pages/TechnicalHotline.aspx. Members can also email questions to aahotline@aicpa.org. Additionally, members can submit questions by completing a Technical Inquiry form found on the same website.

### *Ethics Hotline*

**.116** 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 (press "6" and then "1" on your phone's keypad) or by email at ethics@aicpa.org.

## The AICPA CPEA

**.117** The CPEA is a new service available to PCPS member firms. They provide expertise and resources in a straight-forward and clear style. Written responses to technical inquiries, webcasts on hot topics, and monthly A&A reports and alerts are helping practitioners understand and implement the authoritative professional literature with respect to audits, reviews, compilations, and preparation of financial statements. To join the CPEA and take advantage of these valuable resources and guarantee your practice 1 seat at 8 annual webcasts (16 CPE credits), go to www.aicpa.org/CPEA.

 

## AICPA Online Professional Library: Accounting and Auditing Literature

**.118** 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 anywhere that you can get online to the FASB *Accounting Standards Codification*®, the AICPA's latest *Professional Standards*, *Technical Questions and Answers*, Audit and Accounting Guides, Audit Risk Alerts, Best Practices in Presentation and Disclosure; and more. To subscribe to this essential online service for accounting professionals, visit www.AICPAStore.com.

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

**.119** 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.AICPAStore.com (product no. APACTB15P [paperback]; APACTB15E [e-book]; APACTBO [online]).

## Financial Reporting Center of AICPA.org

**.120** CPAs face unprecedented changes in financial reporting. As such, the AICPA has created the FRC to support you in 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.

**.121** The FRC provides timely and relevant news, guidance, and examples supporting the financial reporting process. You will find resources for accounting, preparing financial statements, and performing various types of engagements, including compilation and review, audit and attest, and assurance and advisory.

**.122** For example, the FRC offers a dedicated section to Review, Compilation, and Preparation engagements. For the latest resources available to help you implement the clarified standards, visit the "Review, Compilation, and Preparation" page at www.aicpa.org.

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## Appendix A—Additional Internet Resources

Here are some useful websites that may provide valuable information to accountants who perform reviews, compilations, and engagements to prepare financial statements, 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<br>www.cpa.com<br>www.ifrs.com |
| AICPA Standards and Statements | One central location to access the standards and statements that the AICPA develops, issues, and enforces. Includes the following:<br>• Statements on Standards for Accounting and Review Services<br>• Auditing standards<br>• Quality Control standards<br>• Code of Professional Conduct<br>• Peer Review standards | www.aicpa.org/Research/Standards/Pages/default.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; review, compilation, and financial statement preparation engagement services; and assurance and advisory services. | www.aicpa.org/frc |

*(continued)*

| *Website Name* | *Content* | *Website* |
|---|---|---|
| AICPA Accounting and Review Services Committee | Summaries of standards for reviews, compilations, and engagements to prepare financial statements. | www.aicpa.org/Research/Standards/CompilationReview/ARSC/Pages/ARSC.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 |
| 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 |
| 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 |
| USA.gov | Portal through which all government agencies can be accessed. | www.usa.gov |
| Government Accountability Office | Policy and guidance materials and reports on federal agency major rules. | www.gao.gov |

| *Website Name* | *Content* | *Website* |
|---|---|---|
| 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 standard-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 |

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# Exhibit—Interpretation No. 1, "Considerations Related to Reviews Performed in Accordance With International Standard on Review Engagements (ISRE) 2400 (Revised), Engagements to Review Historical Financial Statements"

***1. Considerations Related to Reviews Performed in Accordance With International Standard on Review Engagements (ISRE) 2400 (Revised)*, Engagements to Review Historical Financial Statements**

**.01**

*Question*—Section 90, *Review of Financial Statements*, requires that the written review report include a statement that the accountant's responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA.[1] May a practitioner also indicate that the review was conducted in accordance with ISRE 2400 (Revised), issued by the International Auditing and Assurance Standards Board?

**.02**

*Interpretation*—Yes. A practitioner may review the financial statements of an entity in accordance with SSARSs and in accordance with another set of review standards (for example, ISRE 2400 [Revised]). In circumstances in which the accountant's review report states that the review was conducted in accordance with SSARSs and another set of review standards, the practitioner should comply with both sets of standards.

The following illustrates an independent accountant's review report in which the review was conducted in accordance with both SSARSs and ISRE 2400 (Revised).

Circumstances include the following:

- Review of a complete set of general purpose consolidated financial statements (comparative).
- Financial statements prepared in accordance with accounting principles generally accepted in the United States of America.

**Independent Accountant's Review Report**

[*Appropriate Addressee*]

I (We) have reviewed the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X2 and 20X1, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements. A review includes primarily applying analytical procedures to management (owners') financial data and

[1] Paragraph .39*e*(i) of section 90, *Review of Financial Statements*.

 

making inquiries of company management (owners). A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, I (we) do not express such an opinion.

***Management's Responsibility for the Financial Statements***

Management (Owners) is (are) responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement whether due to fraud or error.

***Accountant's Responsibility***

My (our) responsibility is to conduct the review engagements in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA and in accordance with International Standard on Review Engagements 2400 (Revised) issued by the International Auditing and Assurance Standards Board. Those standards require me (us) to perform procedures to obtain limited assurance as a basis for reporting whether I am (we are) aware of any material modifications that should be made to the financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. I (We) believe that the results of my (our) procedures provide a reasonable basis for my (our) conclusion.

***Accountant's Conclusion***

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

[*Signature of accounting firm, or accountant, as appropriate*]
[*Accountant's city and state*]
[*Date of the accountant's review report*]

The accountant should not refer to having conducted a review in accordance with ISRE 2400 (Revised) in addition to SSARSs, unless the review was conducted in accordance with both sets of standards in their entirety.

[Issue Date: February 2016.]