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Communication Between Predecessor and Successor Accountants

SSARS No. 4

By Richard A. Scott

Statement on Standards for Accounting and Review Services No. 4 (SSARS 4) is an amendment to SSARS No. 2. The latter document, in discussing comparative financial statements involving predecessor accountants, suggests that successor accountants may wish to consider the guidance in SAS No. 7, "Communications Between Predecessor and Successor Auditors." However, the objective of SAS No. 7 is to provide guidance when a change in auditors has occurred, or is in process, and the successor auditors are to perform an examination in accordance with generally accepted auditing standards. The inappropriateness of this auditing standard made it necessary to issue a pronouncement expressly for compilation and review situations, and SSARS No. 4 was the result.

There are three principal directives contained in this standard which offer successor accountants guidance on:

- communications they may wish to have with the predecessor accountants before accepting an engagement.
- additional communications they may wish to have with the predecessor accountants to facilitate the engagement.
- situations discovered during the successors' engagement that seem to call for revision of prior period statements reported on by the predecessor.

Predecessor accountants are instructed how to respond to the first two types of communications. SSARS 4 applies when there are successor and predecessor accountants of a nonpublic entity. The successor accountants are the ones who have been invited to propose on a compilation or review engagement or who have already accepted it. The predecessors are those who have resigned or been dismissed by the client. A minimum requirement, however, is that the predecessor accountants had compiled the client's financial statements (1) for the prior year or (2) for a period ended within 12 months of the date of the financial statements to be compiled or reviewed by the successors.

Pre-Acceptance Communications

CPA firms are required to have a system of quality controls to ensure that their accounting and auditing work meets professional standards. One element of quality control concerns acceptance (and continuation) of clients. Statement on Quality Control Stand-

ards No. 1 specifies that a firm's quality controls should minimize the likelihood of association with a client whose management lacks integrity. Successor accountants must be selective in determining their professional relationships. Consequently, they may want to question the predecessor accountants about the integrity of management (owners) before accepting the engagement. It is not required that the successors communicate with the predecessors, however. They may also want to hear the predecessors' opinion of why accountants are being changed. Is this a case of "shopping" for accountants who will sanction accounting principles that the predecessors disagreed with, or who will not insist on performing certain procedures to which the client is opposed? It may also be useful to know whether the client is cooperative when it comes to providing additional or revised information, if necessary. Answers to these questions can be most readily obtained by communicating with the predecessor accountants.

SSARS No. 4 describes other circumstances when it may be advisable to communicate with the predecessor accountants before accepting the engagement. These include communicating when:

- information from other sources is limited or seems to require special attention.
- the change in accountants occurs well after the end of the fiscal reporting period.
- there have been frequent changes in accountants.

Pre-acceptance communications by successor accountants can be made orally or in writing, and may take place even before a proposal is made.

Steps To Follow

Because Ethics Rule 301 prohibits the disclosure of any confidential information, except with the client's consent, the predecessor accountants cannot tell the successors anything about the client or their experiences with the engagement unless given permission to do so. Successor accountants must request permission of the prospective client to communicate with the predecessors, if that has been the course of action they have decided upon. They also should ask the client to authorize the predecessor accountants to reply fully to their questions. In
the event that the successors’ requests are denied, they should ask for an explanation and consider the implications of the prospective client’s behavior as they make their decision whether to accept the engagement.

Normally, it would be expected that permission would be granted and the successor accountants would question the predecessors. The latter are required to respond promptly, fully and factually. There may be occasions when the predecessor accountants will not respond fully, such as when a lawsuit is pending—although unpaid fees would not be considered a legitimate basis for reticence. When this occurs, the predecessors are required to indicate that their response is limited. If a limited response is encountered, the successor accountants must consider its implications in deciding whether to accept the engagement.

Facilitating Communications

If no reason to reject the engagement surfaces out of the communications described above, the successor accountants may find it beneficial to have other communications with the predecessor. These might be thought of as “second stage” communications to obtain information that will facilitate the compilation or review. They may be held either before or after accepting the engagement.

For example, the successors might question whether any phases of the job were particularly troublesome or unusually time-consuming. They might also inquire whether the client’s records and books of account were deficient and whether other accounting services had to be performed (e.g., making adjustments or providing consultation).

Another tactic that can facilitate the engagement is reviewing the predecessors’ working papers. However, the form and content of working papers—particularly those for a compilation—may not have progressed to the point where it is a foregone conclusion that access to them will be useful. Preliminary questioning about the nature of the predecessors’ working papers will prove expedient before requesting access. Predecessor accountants will customarily stand ready to participate in these communications and to make certain of their working papers available, providing, of course, that the client has given its authorization.

Those working papers that have continuing accounting significance, or that relate to contingencies, are the ones of interest to the successor accountant. Agreement should be reached beforehand by the accountants as to which working papers can be reviewed and copied. No mention of this review, the predecessors’ work or their report is to be made in the successor accountants’ report, except as permitted. All information exchanged by the predecessor and successor accountants whether through inquiry or working paper review, is to be held confidential.

Before the successor accountants were appointed, there may have been several firms competing for the engagement. It could be burdensome for the predecessor accountants to have second stage exchanges or to make their working papers accessible to every competing firm. Consequently, the predecessor accountants may require them to wait until one firm is awarded the engagement.

Subsequent Discoveries By Successor

During the engagement, the successor accountants may discover information, considered reliable, suggesting that the prior financial statements compiled or reviewed by the predecessor accountants may require revision. The predecessor accountants have prescribed responsibilities if the information existed at the date of their report and would have affected it accordingly. Therefore, the successor accountants should request their client to inform the predecessors of this information. Failure to do so to the satisfaction of the successors would probably warrant legal consultation.

NOTES

1 Paragraph 42 of SSARS 1 and SAS 1, section 561, guide the predecessor accountants in determining an appropriate course of action if “subsequent discoveries” are made by the successors.
2 If there are valid business reasons, such as unpaid fees, the predecessor accountants may refuse to allow their working papers to be reviewed.
3 To allow for presentation of comparative financial statements when a predecessor accountants’ report on the statements of a prior period is not reissued, successors can refer to it in their report as described in SSARS 2 paragraph 17 (for a nonpublic entity) and SAS 26, paragraphs 15 and 17 (for an unaudited public entity).

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