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THE ACCOUNTING PROFESSION'S EXPERIENCE WITH COMPILATION AND REVIEW

By Wayne G. Bremser and Robert P. Derstine

On July 1, 1979, Statement on Standards for Accounting and Review Services No. 1 (SSARS No. 1) inaugurated a new era in reporting on non-public companies by CPAs.¹ It specified procedural and reporting standards for two levels of service — compilations and reviews of financial statements. SSARS No. 1 required CPAs to issue either a compilation or review report for nonpublic firms instead of the disclaimer report required by the superseded unaudited standards.

Since SSARS No. 1 was a major change in reporting, some implementation problems could be reasonably expected. Based on this perspective, our study's basic objective was to discover how practitioners viewed the recommended compilation and review procedures and reporting requirements of SSARS No. 1. Data was collected by interviewing CPAs and mailing a questionnaire to CPA firm partners.

Background

In performing a *compilation* engagement, the accountant is required to obtain a general understanding of the

client's business transactions, the accounting records, the qualifications of accounting personnel, and the form and content of the financial statements. The accountant must also read the financial statements before issuing a compilation report. The accountant's compilation report does not express an opinion or any other form of assurance.

For a review engagement, the accountant must obtain an understanding of the client's industry and business, make inquiries, and perform analytical review procedures. In the standard SSARS review report, the accountant expresses limited assurance. The report states, "we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles." The report also states that inquiries and analytical review procedures were used.

Our questionnaire was mailed to 400 CPA firm partners. One hundred and twenty usable responses were received (a 30 percent response rate).²

Respondents were asked to evaluate statements concerning:

- 1) A list of SSARS No. 1 procedures.
- 2) Use of analytical review procedures.
- 3) Their opinions about banker and client understanding of review reports.
- 4) Their overall assessment of SSARS No. 1.
- 5) The extent to which they actually use engagement and representation letters when performing compilations and reviews.

The following biographical data were collected for the purpose of analyzing the responses:

- 1) Number of review engagements performed or supervised which was used as a measurement of review engagement experience.
- 2) Number of professional personnel in the respondent's firm which was used to measure firm size.
- 3) Whether the respondent's firm is a member of the AICPA Division for CPA firms.

Every CPA firm partner performed at least one SSARS review. Fifty-four percent of the CPAs were from smaller firms with ten or fewer professionals. Of the 107 CPAs who answered the questions about AICPA Divisions for CPA firms membership, 53 (or 50 percent) declared their membership.

Findings

Questions presented in a statement format were asked to test the CPA firm partners' assessment of SSARS No. 1.³ The CPAs could answer using a scale from one to five, indicating strong disagreement, disagreement, undecided, agreement and strong agreement, respectively. In general, the responses indicated two things:

1. Few respondents were undecided on their feelings towards SSARS No. 1 procedural and reporting requirements.
2. There is substantial divergence in the respondents' attitudes.

Reporting Procedures

The first group of statements in the questionnaire tested the respondents' attitudes towards reporting procedures disallowed by SSARS No. 1. For three of the seven statements, a majority of the respondents agreed with reporting procedures *disallowed* by SSARS No. 1. Specifically a majority of the

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practitioners responding to the questionnaire agree that: 1) a CPA should *not* be required to issue a compilation report to accompany a pencil draft of financial statements prepared by the CPA if the CPA's name is not otherwise associated with them, 2) a compilation report is *not* justified when a CPA just reads, types, and reproduces client prepared statements, and 3) a CPA should have a right to specify in a compilation report that the financial statements are "for management purposes only".

In addition to disagreement with these three reporting requirements of SSARS, the issue of whether a nonindependent CPA should be allowed to issue a review report caused an almost equal split among the practitioners. Forty-eight percent of the respondents believed a review report should be allowed as long as the lack of independence is disclosed. Fifty-two percent of the respondents agreed with the SSARS prohibition on issuing a review report when independence is lacking. There were no undecided answers.

Analytical Review Procedure on a Review Engagement

Two questionnaire statements were asked involving analytical review procedures. There was considerable support for analyzing year-to-year changes in account balances. However, almost 30 percent of the respondents did not feel even this most fundamental level of analytical review was required in a review engagement. There was even less agreement with the necessity of performing ratio analysis of important financial statement components. Forty-three percent of the respondents did not believe ratio analysis must be performed on a review engagement. The extent of the respondents non-usage of analytical review procedures was surprising because SSARS No. 1 specifically states that the desired level of assurance required for a review report should be achieved by using both inquiries and analytical review procedures. We interviewed CPAs on these findings and found that some of them never use analytical review as an SSARS review procedure.

We foresee this as a problem facing the profession because the wording in SSARS No. 1 does emphasize analytical review procedures. Also, the standard SSARS review report states that

analytical review procedures were used. This divergence between the SSARS review report and practice is potentially serious.

Banker and Client Understanding

When SSARS No. 1 was issued, some CPAs were very concerned about the confusion the new levels of services might cause. There was fear of confusion among clients and financial statement users. Bankers are probably the most frequent users other than management. Respondents were asked the extent to which they agreed with the statements that "bankers seem to understand review reports" and "clients seem to understand review reports".

Only a minority of the CPA firm partners (35 percent) agreed that bankers seem to understand the meaning of an SSARS review report; (34 percent agreed that clients understand). The authors' interviews with CPAs support these findings. A few CPAs also indicated that some clients and bankers misunderstood the meaning of an audit report. If the CPAs impressions are valid, a crucial problem exists.

The issuance of SSARS No. 1 in December 1978 was followed by a barrage of seminars for CPAs, bankers, and other business groups sponsored by various professional organizations. The AICPA and state societies supplied free pamphlets to CPAs for their clients and other interested parties. A more extensive and continuing educational effort seems to be needed. The profession faces an ongoing challenge to educate the public on the difference among audits, reviews, and compilations.

Overall Assessment

The CPA firm partners' overall assessment of SSARS No. 1 was very favorable. Most of the respondents (65 percent) disagreed that the procedures recommended by SSARS No. 1 are too extensive. Only 15 percent agreed with the proposition of having another level of assurance somewhere between a review and an audit. Only 23.1 percent viewed the reporting requirements for compilations and reviews as being too complicated. In response to the statement, "having compilation and review is a significant improvement over just unaudited services", 63 percent agreed. While there are some disagreements with SSARS

No. 1, most CPAs interviewed seemed to like being able to offer clients a choice of a compilation or a review as an alternative to an audit.

Conclusions

Overall, questionnaire results indicated that CPA firm partners viewed compilation and review reporting as a significant improvement over having only unaudited services. However, there was considerable dissatisfaction with certain aspects of compilation and review reporting. Preliminary and follow-up interviews with CPAs support the questionnaire findings of some disenchantment with SSARS No. 1's requirements. Perhaps the greatest problem identified by this study was the perception by the CPA that bankers and clients generally do not understand the meaning of a review report.

The study identifies several challenges for the profession. The greatest one is for all practitioners to educate the public about the meaning of a review report. In addition, an increased effort is needed to convince practitioners of the propriety of some of SSARS requirements or perhaps new standards are needed for more controversial aspects of SSARS No. 1. Ω

NOTES

¹American Institute of Certified Public Accountants, *Compilation and Review of Financial Statements*, Statement on Standards for Accounting and Review Services No. 1 (AICPA 1979).

²A comparison between early and late responses to the questionnaire revealed no apparent differences. This test for nonresponse bias assumes late respondents are similar to nonrespondents (see Oppenheim, H.N., *Questionnaire Design and Attitude Measurement*, Basic Books, 1966).

³For a complete copy of the questionnaire and the responses received, write directly to the authors.



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