SSARS Nos 21-23 Update

Part 1 – Preparation of Financial Statement Engagment

3 Hours

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The New Compilation and Review Standards- SSARS Nos 21- 23

The purpose of this course is to inform the reader of the various changes made to the compilation and review codification by SSARS No. 21 as amended by SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services- 2016.* The course addresses the three types of engagements that can be performed under the SSARSs: a preparation of financial statements engagement, a compilation engagement, and a review engagement. The course also discusses SSARS No. 22, Compilation *of Pro Forma Financial Information.*

After reading the Sections I and II course material, you will be able to:

- Identify some of the changes in SSARS No. 21, as amended by SSARS No. 23, that are and are not carried over from auditing standards
- Identify engagement types that are and are not authorized under SSARS No. 21

After reading the Section III course material, you will be able to:

- Recall whether the AR-C 70 preparation of financial statements standard is an attest or nonattest service
- Identify some of the preparation engagements that are subject to the AR-C 70 standards found in SSARS No. 21
- Recognize the term that is assigned to engagements performed on the cash, tax and regulatory bases of accounting
- Recall whether a preparation engagement under AR-C 70 is subject to peer review
- Identify whether a report is required in a preparation of financial statements engagement under AR-C 70
- Recognize what the reporting requirements are, if any, when a "no assurance" legend is omitted from prepared financial statements under AR-C 70
- Recognize an acceptable location to place the description of a special purpose framework in a preparation of financial statements engagement
- Identify where to disclose GAAP departures in a preparation of financial statements engagement
- Recognize whether an accountant and his or her client must sign an engagement letter for a preparation of financial statements engagement under AR-C 70

Field of study:	Auditing
Level of knowledge:	Overview
Prerequisite:	General understanding of U.S. GAAP
Advanced preparation:	None
Recommended CPE hours:	3
Course qualification:	Qualifies for both NASB QAS and Registry CPE credit based on a 50-minute per CPE hour measurement
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SSARS Nos 21- 23 Update 1 – Preparation of Financial Statements Engagment

I. Overview of the New Standards

A. Issued

SSARS No. 21: October 2014
SSARS No. 22: September 2016
SSARS No. 23: October 2016

B. Effective Date

SSARS No. 21 is effective for engagements performed in accordance with SSARSs for periods *ending on or after December 15, 2015*. Early implementation is permitted.

The changes found in SSARS No. 22 are effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

The changes found in SSARS No. 23 are effective upon issuance in October 2016. The exception is that the revisions related to the preparation of prospective financial information are effective for prospective financial information prepared on or after May 1, 2017. The revisions related to the compilation of prospective financial information are effective for compilation reports on prospective financial information dated on or after May 1, 2017.

C. Objective

The purpose of SSARS Nos. 21-23 is to reissue the compilation and review standards under the Accounting and Review Services Committee's (ARSC's) Clarity Project.

D. Background

In October 2014, the AICPA's Accounting and Review Services Committee (ARSC) issued SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification.*

The issuance of SSARS No. 21 represents the culmination of the ARSC's Clarity Project under which it clarifies and revises the previous standards for reviews and compilations found in SSARS No. 19, and introduces a new engagement to prepare financial statements.

In 2011, the Auditing Standards Board (ASB) reissued most of the existing auditing standards under its own Clarity Project with the issuance of SAS Nos. 122-124, which were subsequently supplemented with SAS Nos. 125-131. In issuing those clarified auditing standards, with an effective date of 2012, the ASB had as its primary goal, to make improvements to existing auditing standards. The ASB achieved that goal by establishing certain standard drafting conventions to more clearly state the auditor's objectives, and make the standards easier to read, understand and apply.

In May 2010, the ARSC approved and initiated its own Clarity Project to revise existing compilation and review standards in the *Codification of Statements on Standards for Accounting and Review Services* (AR sections of the AICPA's *Professional Standards*). That project resulted in the issuance of SSARS No. 21.

In issuing SSARS No. 21, the ARSC followed a similar approach taken by the ASB to simplify existing compilation and review standards. The ARSC's approach incorporated into SSARS No. 21 some, but not all, of the conventions that were used within the reissued auditing standards such as:

- Establishing objectives for each clarified standard section
- Including a definitions section, where relevant, in each new standard section
- Separating requirements from application and other explanatory material
- Numbering application and other explanatory material paragraphs using a prefix and presenting them in a separate section that follows the requirements section, and
- Enhancing the readability of the SSARS by using formatting techniques, such as bulleted lists.

The ARSC did not include in SSARS No. 21 specific application guidance for governmental entities and smaller, less complex entities, both of which were included in the new auditing standards.

SSARS No. 21 supersedes SSARS No. 19 (AR sections 60, 80 and 90) and all other previously issued compilation and review interpretations (AR) sections in AICPA Professional Standards except for AR section 120, *Compilation of Pro Forma Financial Information.* AR section 120 was superseded with the 2016 issuance of SSARS No. 22, *Compilation of Pro Forma Financial Information.*

SSARS No. 21 consists of *<u>four AR sections</u>* as follows:

AR-C Section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*
AR-C Section 70, *Preparation of Financial Statements*
AR-C Section 80, *Compilation Engagements*
AR-C Section 90, *Review of Financial Statements*

These four sections replace the previous AR sections with an "AR-C" to differentiate the new sections from the previous ones. Sometime after the effective date of SSARS No. 21, the "C" will be dropped from the new sections.

In March 2015, the AICPA issued an implementation guide for SSARS No. 21 titled *Preparation, Compilation, and Review Engagements*. The Guide is considered an interpretation publication issued in accordance with AR-C 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services.* As an interpretive publication, the guide provides recommendations on the use of the SSARSs. If an accountant does not apply the guidance within the Guide, the accountant should be prepared to explain how he or she complied with the provisions within the Guide. Throughout this course, the author references the AICPA Guide as the "Guide," or the "AICPA Guide."

Following is a mapping of previous AR sections in SSARS No. 19 to AR-C sections found in SSARS No. 21:

Previous Standards (SSARS No. 19)	New AR-C Section (SSARS No. 21)	Description of Changes
AR Section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*	AR-C Section 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*	The new AR-C 60 includes the general principles for engagements performed under the SSARSs and replaces existing AR 60.
NONE	AR-C Section 70, *Preparation of Financial Statements*	AR-C 70 is a new section that contains the requirements and guidance for performing a preparation of financial statements engagement.
AR Section 80, *Compilation of Financial Statements*	AR-C Section 80, *Compilation Engagements*	New AR-C 80 replaces existing AR 80 with respect to compilation engagements.
AR Section 90, *Review of Financial Statements*	AR-C Section 90, *Review of Financial Statements*	New AR-C 90 replaces existing AR 90 with respect to review engagements.

In addition to the new standards replacing previous AR Sections 60, 80 and 90, all other existing AR sections are replaced by SSARS No. 21 except for AR Section 120, *Compilation of Pro Forma Financial Information*,[1] as follows:

[1] In 2016, the ARSC issued SSARS No. 22, *Compilation of Pro Forma Financial Information*, which supersedes AR 120, *Compilation of Pro Forma Financial Information.*

Other AR Sections Superseded by SSARS No. 21			
Previous AR Section	**Previous Title**	**Superseded by SSARS No. 21**	**Not Superseded by SSARS No. 21**
AR Section 200 (SSARS No. 2, as amended)	Reporting on Comparative Financial Statements	X	
AR Section 300 (SSARS No. 3, as amended)	Compilation Reports on Financial Statements Included in Certain Prescribed Forms	X	
AR Section 400 (SSARS No. 4, as amended)	Communications Between Predecessor and Successor Accountants	X	
AR Section 600 (SSARS No. 6, as amended)	Reporting on Personal Financial Statements Included in Written Personal Financial Plans	X	
AR Section 110 (SSARS No. 13, as amended)	Compilation of Specified Elements, Accounts, or Items of a Financial Statement	X	
AR Section 120 (SSARS No. 14, as amended)	Compilation of Pro Forma Financial Information		X Superseded by SSARS No. 22

The key changes made by SSARS No. 21:

SSARS No. 21 makes several important changes to existing compilation and review standards which are summarized below:

a. Introduces new general principles for performing engagements under the SSARSs in newly issued AR-C Section 60

AR-C 60 does the following:

- Establishes the preconditions that must be met to perform an engagement under the SSARSs
- Inserts into AR-C 60 some of the definitions found in auditing standards that are based on SQCS No. 8, A *Firm's System of Quality Control*
- Clarifies that the financial statements on which an accountant performs a SSARS engagement belong to the client, not the accountant
- Expands the guidance on selection of the applicable financial reporting framework and overall guidance as requirements that must be met to prepare financial statements
- Expands the discussion and requirement for an accountant to exercise professional judgment
- Inserts new language on engagement-level quality control and the responsibilities of an engagement partner, and
- Inserts new guidance on acceptance and continuance of client relationships and engagements.

b. Introduces new rules and guidance for engagements to prepare financial statements in newly issued AR-C Section 70

AR-C 70 does the following:

- States that a preparation of financial statements engagement applies when the accountant is engaged to prepare financial statements but is not engaged to perform an audit, review or a compilation on those financial statements
- Establishes criteria that must be met for an accountant to accept and continue client relations in a preparation of financial statements engagement
- Permits the issuance of prepared financial statements without a report provided a legend is placed on each page of the financial statements stating "no assurance is being provided on the financial statements"
- Defines a preparation of financial statements as a nonattest service
- Requires an accountant to obtain an engagement letter signed by both the accountant and the client's management
- Does not require the accountant to consider whether he or she is independent in a preparation of financial statements engagement
- Permits prepared financial statements to be issued with or without disclosures, and
- Inserts into AR-C 70 the new special purpose framework definition (including a new definition of "tax basis") that is presently found in auditing standards.

c. Makes changes to existing compilation engagement requirements in new AR-C Section 80

AR-C 80 does the following:

- Retains most, but not all, of the existing requirements for a compilation engagement
- Establishes criteria that must be met for an accountant to accept and continue client relations in a compilation engagement
- States that a compilation engagement applies only when an accountant is engaged to perform a compilation engagement
- Eliminates the previous requirement that an accountant must perform a compilation engagement if he or she has submitted financial statements (e.g., prepared and presented them)
- States that a compilation engagement always requires a report
- Eliminates the previous management-use only compilation engagement
- Shortens and simplifies the compilation report versus the review or audit report, so that the new standard compilation report contains one paragraph, no heading, and no addressee
- Retains the requirement that an accountant modify the accountant's compilation report whenever the accountant's independence is impaired
- Requires the accountant to obtain an engagement letter signed by both the accountant and the client's management
- Includes a new sample engagement letter for a compilation engagement
- Retains the rules that a compilation engagement may be applied to financial statements with or without disclosures
- Expands the scope of compilation engagements under AR-C 80 to include a compilation of prospective financial information, including budgets, forecasts, or projections, and

- Inserts into AR-C 80, the new special purpose framework definition (including a new definition of "tax basis") that is presently in auditing standards.

d. Makes changes to existing review engagement requirements in new AR-C Section 90

AR-C 90 does the following:

- Establishes criteria that must be met for an accountant to accept and continue client relations in a review engagement
- Inserts into the new AR-C 90, the special purpose framework definition (including a new definition of "tax basis") that is presently found in auditing standards
- Requires the accountant to obtain an engagement letter signed by both the accountant and the client's management
- Includes a new sample engagement letter for a review engagement
- Slightly modifies the list of items that must be documented in a review engagement
- Inserts into AR-C 90 the requirement that an accountant should perform a review engagement with professional skepticism
- Includes a requirement that the accountant should communicate with management or those charged with governance matters concerning the review engagement that are of *significant importance*
- Clarifies that an accountant may perform audit procedures during a review engagement and the engagement is not elevated to an audit engagement
- Expands slightly the list of examples of inquiries that an accountant may make of management in a review engagement
- Expands slightly the examples of analytical procedures and provides additional language that clarifies that the accountant must develop expectations in performing analytical procedures
- Includes a new requirement that an accountant should obtain evidence that the financial statements agree or reconcile with the accounting records
- Replaces the concept of "illegal acts" with "noncompliance with laws and regulations," consistent with a change made to auditing standards
- Adds a new management representation letter, and a new requirement for management to attach to the representation letter a summary of uncorrected misstatements that are immaterial
- Introduces a new and expanded review report that includes headings and expanded language, consistent with some of the changes made to the audit report
- Provides better guidance regarding how an accountant should date the review report
- Introduces a new "other-matter" paragraph in a review report, consistent with this addition found in an audit report
- Clarifies the reporting options with respect to supplementary information in a review engagement, including the option to compile, review or disclaim supplementary information, and
- Includes expanded requirements and guidance in dealing with other accountants who have reviewed financial statements of significant components.

In drafting the new compilation and review standards, the ARSC did not follow international standards and, instead, used the auditing standards format as a guide.

Per the ARSC, some of the AU-C auditing standards were drafted using the corresponding International Standard on Auditing (ISA) as guidance. In contrast, the ARSC noted it was more appropriate to converge with the corresponding limited assurance engagement guidance in the American auditing literature than use international standards found in ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*. Although the ARSC has considered International Standard on Related Services (ISRS) 4410, *Engagements to Compile Financial Statements*, and has adopted some of its requirements, AR-C 80 (compilation engagements) is not identical to ISRS 4410 because there continues to be several underlying premises, such as the requirement to determine independence, which is different in the United States.

Because SSARS No. 21 replaces most existing compilation and review standards, there will be a period during which practitioners will have little guidance in certain areas that have been superseded by SSARS No. 21. One of those areas involves reporting on prospective financial information.

Issuance of SSARS No. 22: *Compilation of Pro Forma Financial Information.*

In September 2016, the ARSC issues SSARS No. 22, Compilation *of Pro Forma Financial Information.* SSARS No. 22 represents the final portion of the ARSC Clarify Project after which all previous compilation and review standards have been replaced by SSARS Nos. 21 (as amended by SSARS No. 23), and SSARS No. 22.

SSARS No. 22 replaces previous AR 120, *Compilation of Pro Forma Financial Information* with new AR-C 120, and reflects the new clarify format.

In general, SSARS No. 22 does the following:

1. SSARS No. 22 defines pro forma financial information as:

   "a presentation that shows what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date."

2. In performing a compilation of pro forma financial information, an accountant is required to apply his or her accounting and reporting expertise to assist management in the presentation and reporting of pro forma financial information.

3. The compilation of pro forma financial information does not involve providing any assurance on the pro forma financial information.

4. In performing a compilation of pro forma financial information, an accountant is required to comply with the requirements of AR-C 120, and the general principles found in AR-C 60 of SSARS No. 21, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*.

5. SSARS No. 22 deals with the following issues related to a compilation of pro forma financial information:

   - Independence
   - Acceptance and continuance of client relationships
   - Agreement on engagement terms

- Accountant's knowledge and understanding of the entity's financial reporting framework
- Compilation procedures in a pro forma engagement
- Accountant's compilation report on pro forma financial information
- Documentation in a compilation of pro forma financial information engagement

SSARS No. 22 is effective for compilation reports on pro forma financial information dated on or after May 1, 2017.

Issuance of SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services-2016.*

In October 2016, the ARSC issues SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services- 2016.* The purpose of SSARS No. 23 is to amend certain provisions and language found in SSARS No. 21.

SSARS No. 23 makes the following key changes to SSARS No. 21:

- Expands the subject matter to which AR-C 70 preparation of financial statements engagement applies to include prospective financial information

- Clarifies that an oral understanding of the terms of the engagement is insufficient.

- Clarifies that, in performing a preparation of financial statements engagement, if the accountant is unable to include a statement on each page of the financial statements indicating that "no assurance is provided" the accountant may withdraw from the engagement.

- Includes a requirement that in performing a preparation or compilation engagement on prospective financial information, the accountant should not perform such engagements that exclude 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

- Expands the subject matter to which a compilation engagement applies to include prospective financial information, pro forma financial information, and other historical financial information

- Clarifies 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

- Clarifies that a review engagement applies to all historical financial information, excluding pro forma financial information

- Expands the definition of financial *statements* and *supplementary information*

- Revises the accountant's reporting responsibilities when supplementary information accompanies reviewed financial statements and the accountant's review report thereon

The remainder of this course is segregated into the following sections:

AR-C Section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*
AR-C Section 70, *Preparation of Financial Statements*
AR-C Section 80, *Compilation Engagements*
AR-C Section 90, *Review of Financial Statements*

The author has integrated the changes made by SSARS No. 23 to SSARS No. 21 directly in this course. Because most of the SSARS No. 23 changes are not substantive, those changes are not reflected separately within the text. In situations in which a SSARS No. 23 change is substantive, the author references that change.

Carryover of certain elements found in auditing standards

In issuing SSARS No. 21, the ARSC carried over certain elements found in auditing standards to the SSARSs. Now, those elements are consistent across all engagements.

Following is a summary of those elements:

	Auditing Standards	**CHANGES BY SSARS NO. 21**		
		Preparation of Financial Statements	**Compilation Engagements**	**Review Engagements**
New definition of special purpose framework including "tax basis" financial statements	√	√	√	√
Introduction of "other matter" paragraph in report	√		√	√
Engagement letter must be signed by accountant and management	√	√	√	√
Replacement of term "illegal acts" with "noncompliance with laws and regulations"	√	√	√	√

II. AR-C Section 60- *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services*

A. Introduction

AR-C 60, General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services, was issued as part of SSARS No. 21, and supersedes previously issued AR-60, Framework for Performing and Reporting on Compilation and Review Engagements which was issued previously as part of SSARS No. 19.

AR-C 60 does the following:

1. It provides the general principles for engagements performed in accordance with the SSARSs involving:

    - Preparation of Financial Statements (AR-C 70)
    - Compilation Engagements (AR-C 80), and
    - Review Engagements (AR-C 90).

2. It establishes the meaning of certain terms used within the SSARSs related to the professional requirements that must be satisfied in performing a review, compilation, or a preparation of financial statements engagement.

3. It assists accountants in understanding their professional responsibilities when performing an engagement in accordance with SSARSs.

Note: AR-C 60 also states that the SSARSs do not address the responsibilities of the accountant that may exist in legislation, regulation, or otherwise, and that may differ from those established in the SSARSs. In such circumstances, use of the SSARSs does not eliminate the accountant's responsibility to comply with all relevant legal, regulatory, or professional obligations.

If the accountant is engaged to perform a professional service in accordance with SSARSs on financial information other than financial statements (for example, the preparation or compilation of prospective financial information or the compilation of pro forma financial information), references to financial statements found in SSARS No. 21 are to be applied to such other financial information.

B. Key Changes Made in New AR-C 60

An accountant who performs an engagement under the SSARSs must follow the general principles found in newly issued AR-C 60, in addition to the requirements related to each engagement.

Thus, in considering the types of engagements covered by SSARS No. 21, an accountant must adhere to the following standards:

Type of Engagement	New Section	General Framework
Preparation of Financial Statements	AR-C 70	**Must follow requirements in AR-C-60, General Principles**
Compilation Engagement	AR-C 80	
Review Engagement	AR-C 90	

Although many of the existing provisions found in AR 60 have been carried over to the newly issued AR-C 60, other elements have been eliminated and the new AR-C 60 adds some new provisions.

Following is a summary of some of the key changes that AR-C 60 makes to the previous AR 60:

1. Inserts into AR-C 60 some of the definitions found in auditing standards that are based on SQCS No. 8, *A Firm's System of Quality Control*

2. Clarifies that the financial statements on which an accountant performs a SSARS engagement belong to the client, not the accountant

3. Expands the guidance on selection of the applicable financial reporting framework and overall guidance as requirements that must be met to prepare financial statements

4. Expands the discussion and requirement for an accountant to exercise professional judgment

5. Eliminates discussion of the concept of materiality in a SSARS engagement

6. Inserts new language on engagement-level quality control and the responsibilities of an engagement partner, and

7. Inserts new guidance on acceptance and continuance of client relationships and engagements.

C. Definitions

AR-C 60 replaces the definitions found in existing AR 60 with new definitions, most of which are reflected in auditing standards. For purposes of SSARSs, the following terms have the meanings attributed as follows:

> **Engagement partner[2]:** The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal, or regulatory body.
>
> **Engagement team[3]:** All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

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2 The term "engagement partner" is brought forward from QC Section 10, A Firm's System of Quality Control, SQCS No. 8 and similarly used in auditing standards per AU-C 220, Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards.

3 The term "engagement team" is brought forward from QC Section 10, A Firm's System of Quality Control, SQCS No. 8 and similarly used in auditing standards per AU-C 220, Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards. That definition is further amended by SSARS No. 23.

Financial statements[4]: A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term financial statements ordinarily refer to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement.

Firm[5]: A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public practice.

Interpretative publications: Interpretations of SSARSs; exhibits to SSARSs; AICPA Guide *Preparation, Compilation, and Review Engagements*, guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

Other preparation, compilation and review publications: Publications other than interpretative publications. including:

- AICPA preparation, compilation, and review publications not defined as interpretive publications
- AICPA's annual alert addressing engagements performed in accordance with SSARSs
- Articles addressing preparation, compilation, and review engagements in the Journal of Accountancy and other professional journals
- Continuing professional education programs and other instruction materials
- Textbooks, guide books, programs for preparation, compilation, and review engagements
- Checklists, and
- Other publications addressing preparation, compilation, and review engagements from state CPA societies, other organizations, and individuals.

Professional judgment[6]: The application of relevant training, knowledge, and experience, within the context provided by SSARSs, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Prospective financial information[7]: Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

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[4] The definition of "financial statements" is an amendment made to SSARS No. 21 by SSARS No. 23.
[5] The term "firm" is brought forward from QC Section 10, A Firm's System of Quality Control, SQCS No. 8 and similarly used in auditing standards per AU-C 220, Quality Control for An Engagement Conducted in Accordance with Generally Accepted Auditing Standards.
[6] As used in auditing standards, AU-C Section 200, General Principles and Responsibilities.
[7] The definition of "prospective financial information" is an amendment made to SSARS No. 21 by SSARS No. 23.

D. Requirements for Performing SSARS Engagements

AR-C 60 provides the general principles that an accountant must satisfy before performing an engagement covered by the SSARSs. Many of the requirements found in the new AR-C 60 are carried over from similar (but not identical) requirements found in auditing standards, more specifically AU-C Section 200, *General Principles and Responsibilities.*

1. There are *three engagements* that SSARS No. 21 authorizes an accountant to perform:

    - Preparation of financial statements
    - Compilation of financial statements
    - Review of financial statements

2. The following sections are addressed within the AR-C 60 requirements that pertain to an accountant who performs any one of the three SSARS No. 21 engagements noted above:

    a. Financial Statement Requirements
    b. Ethical Requirements
    c. Professional Judgment
    d. Conduct of Performing the Engagement in Accordance with SSARSs
    e. Engagement Level Quality Control
    f. Acceptance and Continuance of Client Relationships and Engagements

Financial Statement Requirements:

1. The financial statements that are the subject of a SSARS engagement *belong to the entity, not the accountant*. The SSARSs do not impose responsibilities on management and do not override laws and regulations that govern their responsibilities.

2. Prior to performing a SSARS engagement, an accountant must satisfy the *preconditions* for performing each type of engagement, as defined as:

    - Engagement to prepare financial statements: Follows the preconditions found in paragraphs 9 and 10 of AR-C 70, *Preparation of Financial Statements*.

    - Compilation engagement: Follows the preconditions found in paragraphs 8 and 9 of AR-C 80, *Compilation Engagements*.

    - Review engagement: Follows the preconditions found in paragraphs 8 and 9 of AR-C 90, Review *of Financial Statements*.

    Note: Although each type of engagement has its own list of preconditions that must be satisfied, there are certain preconditions found in paragraphs .25 and .26 of AR-C 60 that apply to all three SSARS engagements.

3. The preparation and fair presentation of the financial statements require:

- The identification of the applicable financial reporting framework, in the context of any relevant laws or regulations
- The preparation and fair presentation of the financial statements in accordance with that framework
- The inclusion of an adequate description of that framework in the financial statements, and
- That management exercise judgment when making accounting estimates that are reasonable in the circumstances, as well as when selecting and applying appropriate accounting policies.

4. The financial statements may be prepared in accordance with one of the following:

   - A general purpose framework (a financial reporting framework designed to meet the common financial information needs of a wide range of users, such as U.S. GAAP, or

   - A special purpose framework, such as tax basis, regulatory basis, or contractual basis financial statements

5. Examples of financial accounting standards issued by organizations to be used by entities for preparing financial statements in accordance with a *general purpose framework* include:

   - FASB standards issued as part of the FASB's *Accounting Standards Codification*®
   - International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB)
   - Statements of Federal Financial Accounting Standards, issued by the Federal Accounting Standards Advisory Board for U.S. federal government entities, and
   - Statements of the Governmental Accounting Standards Board, issued by the Governmental Accounting Standards Board for U.S. state and local governmental entities.

   Note: The requirements of the applicable financial reporting framework determine what constitutes a complete set of financial statements. Under U.S. GAAP, a complete set of financial statements includes a balance sheet, an income statement, a statement of changes in equity, a cash flow statement, and related notes.

   For other financial reporting frameworks, a single financial statement and the related notes might constitute a complete set of financial statements. Examples of a single financial statement, each of which would include related notes, include the following:

   - Balance sheet
   - Statement of income or statement of operations
   - Statement of retained earnings
   - Statement of cash flows
   - Statement of assets and liabilities
   - Statement of changes in owners' equity
   - Statement of revenue and expenses
   - Statement of operations by product lines

   AR-C 60 states that an accountant may perform a preparation, compilation or review engagement on a complete set of financial statements, or on an individual financial statement such as a balance sheet. The standards can also be applied to specified elements, accounts and items, as well as prospective financial statements (in certain cases). The financial statements may apply to either an annual period or for a shorter or longer period, depending on management's needs.

AR-C 60 notes that typically it is not appropriate for the entity to present financial statements for a period longer or shorter than an annual period in a comparative presentation with financial statements for an annual period.

Ethical Requirements:

1. The accountant should comply with relevant ethical requirements when performing an engagement in accordance with the SSARSs.

   a. Ethical requirements consist of those contained in the AICPA Code of Professional Conduct together with rules of state boards of accountancy and applicable regulatory agencies that are more restrictive.

   b. The AICPA Code of Professional Conduct establishes the fundamental principles of professional ethics, which include the following:

      - Responsibilities
      - The public interest
      - Integrity
      - Objectivity and independence
      - Due care
      - Scope and nature of services

   c. Due care requires the accountant to discharge professional responsibilities with competence and to have the appropriate capabilities to perform the engagement and enable an appropriate accountant's report to be issued, if applicable.

   d. QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*), establishes a firm's responsibilities to establish and maintain a system of quality control for SSARS engagements, and to establish policies and procedures designed to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements, including those pertaining to independence.[8]

Professional Judgment:

AR-C 60 expands the guidance related to an accountant's professional judgment:

1. The general rule is that an accountant should exercise professional judgment in the performance of an engagement that is subject to the SSARSs.

2. In exercising his or her professional judgment, AR-C 60 provides some guidance as follows:

[8] Paragraphs .21–.25 of QC section 10, *A Firm's System of Quality Control* (AICPA, *Professional Standards*).

a. Professional judgment is essential to the proper conduct of an engagement performed in accordance with SSARSs because interpretation of relevant ethical requirements and SSARSs, and the informed decisions required throughout the engagement, cannot be made without the application of relevant knowledge and experience to the facts and circumstances.

b. The key feature of the professional judgment is that it is expected to be exercised by an accountant whose training, knowledge, and experience have assisted in developing the necessary competencies to achieve reasonable judgments and make informed decisions about appropriate courses of action in undertaking an engagement in accordance with SSARSs.

c. The exercise of professional judgment in individual engagements is based on the facts and circumstances that are known by the accountant throughout the engagement, including:

- knowledge acquired from engagements carried out for the entity's financial statements in prior periods, where applicable

- the accountant's understanding of the entity and its environment, including its accounting system, and of the application of the applicable financial reporting framework in the entity's industry, and

- the extent to which the preparation and presentation of the financial statements requires the exercise of judgment by management or the accountant.

Note: Professional judgment can be evaluated based on whether the judgment reached reflects a competent application of SSARSs and accounting principles and is appropriate considering the facts and circumstances that were known to the accountant up to the date of the issuance of financial statements prepared by the accountant or the date of the accountant's compilation or review report.

d. Professional judgment needs to be exercised throughout an engagement performed in accordance with SSARSs. It also needs to be appropriately documented in accordance with the requirements of AR-C section 70, *Preparation of Financial Statements*, AR-C section 80, *Compilation Engagements, or* AR-C section 90, *Review of Financial Statements*. Professional judgment is not to be used as the justification for decisions that are not otherwise supported by the facts and circumstances of the engagement or, in a review engagement, the evidence obtained.

Conduct of Performing the Engagement in Accordance with SSARSs:

Complying With AR-C Sections Relevant to the Engagement and Other Relevant Requirements

1. The accountant must perform a review, compilation, or a prepare of financial statements engagement in accordance with SSARSs.

a. There is an exception under which the SSARSs do not apply to a review of interim financial information which is performed under auditing standards, AU-C section 930, *Interim Financial Information* (AICPA, *Professional Standards*).

2. The accountant should comply with all AR-C sections relevant to the engagement. An AR-C section is relevant to the engagement when the AR-C section is in effect, and the circumstances addressed by the AR-C section exist.

   a. An accountant should comply with each requirement of the relevant AR-C section unless, in the circumstances of the engagement, the requirement is not relevant because it is conditional, and the condition does not exist.

   Note: There may be instances in which an accountant also may be required to comply with other requirements in addition to SSARSs. The SSARSs do not override law or regulation that governs a review, compilation, or an engagement to prepare financial statements. If such law or regulation does, in fact, differ from SSARSs, an engagement conducted only in accordance with law or regulation will not necessarily comply with SSARSs.

   Note: An accountant may also conduct the compilation or review of financial statements in accordance with both SSARSs and International Standard on Related Services 4410 (Revised), *Compilation Engagements,* International Standard on Review Engagements 2400 (Revised), *Engagements to Review Historical Financial Statements*, or compilation or review standards of a specific jurisdiction or country. In such cases, in addition to complying with each of the AR-C sections relevant to the engagement, it may be necessary for the accountant to perform additional compilation or review procedures to comply with the other compilation or review standards.

3. An accountant should not represent compliance with SSARSs in the accountant's compilation or review report unless the accountant has complied with the requirements of all AR-C sections relevant to the engagement.

4. The SSARSs apply to engagements to prepare financial statements and compilations and reviews of financial statements of governmental entities.

   Note: The accountant's responsibilities may be affected by law, regulation, or other authority (such as government policy requirements or resolutions of the legislature), which may encompass a broader scope than an engagement performed under the SSARSs. The SSARSs do not encompass these additional responsibilities.

5. AR-C 60 requires that the accountant should understand the entire text of an AR-C section, including its application and other explanatory material, to understand its objectives and apply its requirements properly. The entire text of an AR-C section is relevant to an understanding of the objectives stated in an AR-C section and the proper application of the requirements of an AR-C section.

   a. In addition to objectives and requirements, an AR-C section contains related guidance in the form of:

      - Application and other explanatory material, and
      - Introductory material that provides context relevant to a proper understanding of the AR-C section and definitions.

1) When necessary, the _application and other explanatory material_ provides further explanation of the requirements of an AR-C section and guidance for carrying them out. In it may explain more precisely what a requirement means or is intended to cover, include examples of procedures that may be appropriate in the circumstances. Although such guidance does not in itself impose a requirement, it is relevant to the proper application of the requirements of an AR-C section.

   Note: The accountant is required to understand the application and other explanatory material, how the accountant applies the guidance in the engagement depends on the exercise of professional judgment in the circumstances consistent with the objective of the AR-C section. The words *may*, *might*, and *could* are used to describe these actions and procedures. The application and other explanatory material may also provide background information on matters addressed in an AR-C section.

   Appendices form part of the application and other explanatory material. The purpose and intended use of an appendix are explained in the body of the related AR-C section or within the title and introduction of the appendix itself.

2) Introductory material may include, as needed, such matters as explanation of the following:

   - The purpose and scope of the AR-C section, including how the AR-C section relates to other AR-C sections
   - The subject matter of the AR-C section
   - The respective responsibilities of the accountant and others in relation to the subject matter of the AR-C section, and
   - The context in which the AR-C section is set.

b. An AR-C section may include, in a separate section under the heading "Definitions," a description of the meanings attributed to certain terms for purposes of SSARSs. These are provided to assist in the consistent application and interpretation of SSARSs and are not intended to override definitions that may be established for other purposes, whether in law, regulation, or otherwise. Unless otherwise indicated, those terms will carry the same meanings throughout SSARSs.

Defining Professional Responsibilities in the SSARSs

1. SSARS No. 21 carries over certain terms that describe the degree of responsibility imposed on accountants who perform engagements under the SSARSs:

   _Unconditional requirements_*:* The accountant must comply with an unconditional requirement in all cases in which such a requirement is relevant. An unconditional requirement is earmarked with use of the word *"must."*

   _Presumptively mandatory requirements_*:* The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare instances. Use of the terms *"should"* indicates a presumptively mandatory requirement.

Note: If an AR-C section states that an accountant *"should consider"* performing a procedure or action, consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action, is based upon the outcome of the accountant's consideration and the accountant's professional judgment.

An accountant may depart from a relevant presumptively mandatory requirement in rare instances and such a departure is expected to arise only when the requirement is for a specific procedure to be performed, and, in specific circumstances of the engagement. In such a case, the accountant should perform alternative procedures to achieve the intent of the requirement.

SSARS No. 23 amends SSARS No. 21 to state that if, in rare circumstances, the accountant determines it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Use of Interpretive Publications and Other Preparation, Compilation and Review Publications

1. The accountant should consider applicable *interpretative publications* in the performance of a SSARS engagement.

   a. Interpretative publications:

      - Are not SSARSs and are recommendations on the application of the SSARSs in specific circumstances, including engagements for entities in specialized industries.

      - Are issued under the authority of the ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed publication is consistent with the SSARSs.

   b. Compilation and review interpretations of the SSARSs, and exhibits to the SSARSs are included in the AR-C sections.

2. Other preparation, compilation and review publications have no authoritative status, but might be helpful in understanding and applying the SSARSs. The accountant is not expected to be aware of the full body of other preparation, compilation and review publications.

Note: In March 2015, the AICPA issued an implementation guide for SSARS No. 21 entitled Preparation, *Compilation, and Review Engagements.* The guide is considered an interpretation publication issued in accordance with AR-C 60. In accordance with the standards, if an accountant does not apply the guidance within the guide, he or she should be prepared to explain how he or she otherwise complied with the provisions within the guide.

Engagement Level Quality Control:

AR-C 60 provides guidance on implementing a SSARS engagement in accordance with a firm's quality control standards. In particular, the engagement partner takes responsibility for the engagement.

1. In a SSARS engagement, the engagement partner should possess competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances.

2. The engagement partner should take responsibility for the following:

    a. The overall quality of each engagement to which that partner is assigned

    b. The direction, supervision, planning and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements

    c. The accountant's report being appropriate in the circumstances, if applicable, and

    d. The engagement being performed in accordance with the firm's quality control policies and procedures, including the following:

        1) Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity.

        2) Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the engagement and expertise in financial reporting to:

            - Perform the engagement in accordance with professional standards and applicable legal and regulatory requirements, and
            - Enable a report that is appropriate in the circumstances to be issued, if applicable.

        3) Taking responsibility for appropriate engagement documentation being maintained.

3. <u>Relevant considerations after engagement acceptance:</u> If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner should communicate that information promptly to the firm, so that the firm and the engagement partner can take necessary action.

4. <u>Compliance with relevant ethical requirements</u>: Throughout the engagement, the engagement partner should remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team.

    a. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, should determine the appropriate action.

5. Monitoring: An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively.

    a. The engagement partner should consider the results of the firm's monitoring process of the firm's system of quality control, as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the engagement.

6. Engagement teams, rather than the partner, have a responsibility to:

    a. Implement quality control procedures applicable to the engagement, and

    b. Provide the firm with relevant information to enable the functioning of that part of the firm's system of quality control relating to independence.

Acceptance and Continuance of Client Relationships and Engagements:

Regardless of whether an accountant performs a preparation, compilation or review engagement, the accountant is required to satisfy *certain preconditions* of the engagement found in the following:

- Paragraphs .25 and .26 of AR-C 60, and
- Specific preconditions found in the applicable section of the engagement type (AR-C 70, AR-C 80 or AR-C 90)

Preconditions for all engagements found in AR-C 60:

1. Paragraph .25 of AR-C 60 states that the accountant should not accept an engagement to be performed in accordance with SSARSs if:

    a. The accountant has reason to believe that *relevant ethical requirements* (including independence) will not be satisfied

    b. The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is *not likely to be available or reliable*, or

    c. The accountant has cause to *doubt management's integrity* such that it is likely to affect the performance of the engagement.

    Note: The AICPA Guide notes that one example of when an accountant may determine that information is not likely to be "available" or "reliable" is when financial statements or accounting records necessary to perform the engagement are suspected to be substantially inaccurate or incomplete.

2. Paragraph .26 of AR-C 60 states that as preconditions for accepting a SSARS engagement, the accountant *should do all the following:*

a. Determine whether preliminary knowledge of the engagement circumstances indicates that ethical requirements (including independence) regarding professional competence will be satisfied

b. Determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements _is acceptable_

1) Factors that are relevant to the accountant's determination that the financial reporting framework selected by management *is* _acceptable_ include the following:

- Consideration of the nature of the entity
- The intended purpose of the financial statements
- The users of the financial statements
  Example: Whether they are prepared to meet the common financial information needs of a wide range of users), and
- Whether law or regulation prescribes the applicable financial reporting framework.

Note: The AICPA Guide states that financial statements prepared in accordance with a special purpose framework may not be suitable for general purposes because the users may not fully understand that particular financial reporting framework.

2) The following general purpose frameworks selected by management are _presumed to be "acceptable"_ unless evidence suggests otherwise:

- Accounting principles generally accepted in the United States of America (U.S. GAAP), and
- International Financial Reporting Standards (IFRS).

Note: In addition to the previously noted factors, the AICPA Guide offers additional guidance in determining whether a financial reporting framework is "acceptable" which is whether the financial reporting framework exhibits the characteristics of _suitable criteria_.

Suitable criteria exhibit all the following _four characteristics_:

- Relevance: Criteria are relevant to the subject matter
- Objectivity: Criteria are free from bias
- Measurability: Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter
- Completeness: Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made based on that subject matter.

The AICPA Guide notes that the relative importance of each of the four characteristics to a certain engagement should be considered and is a matter of professional judgment. For example, even though a financial reporting framework may not result in financial statements that meet the objectivity criterion (they are not free from bias), that framework may still be acceptable given the circumstances.

c. Obtain the agreement of management (through an engagement letter) that it acknowledges and understands its responsibility:

   1) for the selection of the financial reporting framework to be applied in the preparation of financial statements

   2) 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, unless the accountant decides to accept responsibility for such internal control

   3) for preventing and detecting fraud

   4) for ensuring that the entity complies with laws and regulations applicable to its activities

   5) for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements

   6) to provide the accountant with:

      - access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters

      - additional information that the accountant may request from management for the engagement, and

      - unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries.

3. In additional to satisfying the preconditions found in paragraphs .25 and .26 of AR-C 60, the accountant must satisfy certain engagement-specific conditions found in AR-C 70 (preparation engagements), AR-C 80 (compilation engagements), and AR-C 90 (review engagements), as follows:

   - <u>Engagement to prepare financial statements</u>: Preconditions found in paragraphs 9 and 10 of AR-C 70, *Preparation of Financial Statements*.

   - <u>Compilation engagement</u>: Preconditions found in paragraphs 8 and 9 of AR-C 80, *Compilation Engagements*.

   - <u>Review engagement</u>: Preconditions found in paragraphs 8 and 9 of AR-C 90, *Review of Financial Statements*.

   The previous preconditions are discussed in each section of this course.

Review Questions and Suggested Solutions

REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect. To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow.

1. Which of the following represents a change made by SSARS No. 21 to the compilation and review standards:
   a. AR-C section 60 represents a new section dealing with general principles that does not supersede any previous section
   b. AR-C section 70 is a new section that does not supersede any previous section
   c. AR-C section 80 is a new section that does not supersede any previous section
   d. AR-C section 90 is a new section that does not supersede any previous section

2. One key change made by SSARS No. 21 which represents a carryover of an element found in auditing standards is which of the following:
   a. The "other matter" paragraph is eliminated from the report consistent with auditing standards
   b. SSARS No. 21 carries over from auditing standards the requirement that analytical procedures be performed in a review engagement
   c. SSARS No. 21 carries over from auditing standards the requirement that an accountant perform inquiries in a review engagement
   d. The term "illegal acts" is changed to "noncompliance with laws and regulations"

3. Bill Taylor is an accountant who is hired to perform a compilation engagement under SSARS No. 21. Bill is considering how he must follow certain interpretative publications in the performance of his engagement. Which of the following is correct in terms of how Bill should handle interpretative publications:
   a. Interpretative publications are part of the SSARSs
   b. Interpretative publications are not part of the SSARSs and are not issued under any authority
   c. Interpretative publications are not part of the SSARSs and are issued under the authority of the ARSC
   d. All interpretative publications are included in the SSARSs as exhibits

4. Sara Winston is an accountant who is performing a review engagement. Sara identifies a procedure within the SSARSs that is earmarked by use of the term *"should consider."* How is Sara supposed to handle this procedure under SSARS No. 21:
   a. The procedure is an unconditional requirement and Sara has a choice to comply with the procedure
   b. The procedure is a presumptively mandatory requirement that must be followed except in rare instances
   c. The term "should consider" has no authoritative requirement as to whether the procedure should be followed
   d. The procedure is an unconditional requirement that Sara must follow in all cases

5. Before an accountant accepts any engagement under SSARS No. 21, which of the following is a precondition that, if not satisfied, would result in the accountant *not* accepting the engagement:
   a. Accountant has concern about the integrity of third parties who might rely on the financial statements
   b. Accountant is concerned about the ethics of the bank to whom financial statements will be sent
   c. Bankers have a history of not responding to receivable and cash confirmations
   d. Accountant doubts management's integrity

SUGGESTED SOLUTIONS

1. Which of the following represents a change made by SSARS No. 21 to the compilation and review standards:
   a. Incorrect. AR-C section 60 supersedes previous AR section 60 found in SSARS No. 19.
   b. Correct. SSARS No. 21 introduces a new AR-C section 70 for preparation of financial statements that did not exist under SSARS No. 19 and did not supersede any previous section.
   c. Incorrect. AR-C section 80 replaces previous AR section 80 which is part of SSARS No. 19.
   d. AR-C section 90 supersedes previous AR section 90, which is part of SSARS No. 19.

2. One key change made by SSARS No. 21 which represents a carryover of an element found in auditing standards is which of the following:
   a. Incorrect. SSARS No. 21 carries over the introduction (and not the elimination) of the "other matter" paragraph which is now authorized by auditing standards.
   b. Incorrect. The requirement to perform analytical procedures in a review engagement is not carried over from auditing standards. This requirement has existed in review standards for years and is not influenced by any auditing standards.
   c. Incorrect. SSARS No. 21 does not carry over from auditing standards the requirement that an accountant perform inquiries in a review engagement. Although it is true that inquiry procedures may be part of an audit engagement, as well as a review engagement, such procedures have been required in a review engagement for years and is not influenced by auditing standards.
   d. Correct. Auditing standards changed the term "illegal acts" to a new term "noncompliance with laws and regulations." The new change is reflected in SSARS No. 21 consistent with the change made in auditing standards.

3. Bill Taylor is an accountant who is hired to perform a compilation engagement under SSARS No. 21. Bill is considering how he must follow certain interpretative publications in the performance of his engagement. Which of the following is correct in terms of how Bill should handle interpretative publications:
   a. Incorrect. SSARS No. 21 states that interpretative publications are not part of the SSARSs and are merely recommendations on how to apply the SSARSs in certain circumstances.
   b. Incorrect. Although it is true that interpretative publications are not part of the SSARSs it is not true that they are not issued under any authority. The Accounting and Review Services Committee (ARSC), an authoritative body, issues the interpretations making the answer partially incorrect.
   c. Correct. SSARS No. 21 states that interpretative publications are not part of the SSARSs and are issued under the authority of the ARSC members. Thus, the answer is correct.
   d. Incorrect. Compilation and review interpretations of the SSARSs, and exhibits to the SSARSs, are included in the AR-C sections of the SSARSs, but not necessarily as exhibits.

4. Sara Winston is an accountant who is performing a review engagement. Sara identifies a procedure within the SSARSs that is earmarked by use of the term *"should consider."* How is Sara supposed to handle this procedure under SSARS No. 21:
   a. Incorrect. The procedure is not an unconditional requirement. An unconditional requirement is identified with use of the term "must" and not "should consider."

- **b. Correct. Use of the term "should consider" means the procedure is presumptively required under SSARS No. 21. A presumptively required procedure is followed except in rare instances and assuming it is also relevant. Thus, the answer is correct.**
- c. Incorrect. The term "should consider" does, in fact, have an authoritative requirement as a presumptively mandatory requirement under SSARS No. 21. Thus, the answer is incorrect.
- d. Incorrect. SSARS No. 21 states that the term "should consider" is not indicative of an unconditional requirement even though it is true that if it were an unconditional requirement Sara would be required to follow the procedure in all cases.

5. Before an accountant accepts any engagement under SSARS No. 21, which of the following is a precondition that, if not satisfied, would result in the accountant *not* accepting the engagement:
   - a. Incorrect. The integrity of third parties who might rely on the financial statements is not listed as a precondition under Paragraph .25 of AR-C 60, making the answer incorrect.
   - b. Incorrect. Whether the bank that will receive the financial statements is ethical or not does not impact the accountant. The accountant is performing the engagement for the entity, and not the bank.
   - c. Incorrect. In a SSARS No. 21 engagement (compilation, review or preparation), generally, confirmation procedures are not performed so that the accountant would not be concerned about whether the bank responds to receivable and cash confirmations. The accountant would, however, be concerned about getting other information that is necessary to perform the engagement.
   - **d. Correct. SSARS No. 21 states that an accountant should not accept a SSARS engagement if he or she doubts management's integrity to the extent that it is likely to affect the accountant's performance of the engagement. Thus, the answer is correct.**

III. AR-C Section 70- *Preparation of Financial Statements*

A. Effective Date

The effective for the preparation of financial statements for periods *ending on or after December 15, 2015*. Early implementation is permitted.

B. Introduction

Although SSARS No. 21 rewrites existing compilation and review standards, clearly the most significant change made by this SSARS is the introduction of a preparation of financial statements engagement within newly issued AR-C 70.

Even though the preparation of financial statements is nothing new, per se, codifying a preparation of financial statements engagement separate from a compilation, review or audit engagement, is novel.

AR-C 70 is a new section within the SSARSs and does the following:

- Introduces a preparation of financial statements engagement as a new engagement that may be performed *separate from* a compilation, review or audit engagement
- Codifies the preparation of financial statements as a *nonattest service*, and
- Provides guidance for the preparation of financial engagements that permits an accountant to issue prepared financial statements to a client or third party *without a report.*

In addition, although not part of AR-C 70, the AICPA's peer review committee has voted to exempt the preparation of financial statements engagement from being subject to peer review in cases in which a firm only performs preparation of financial statement engagements.

C. Scope of AR-C 70

AR-C 70 inserts the preparation of financial statements as a separate engagement within the hierarchy of engagements that may be performed under the SSARSs as follows:

- Review Engagement
- Compilation Engagement
- ***Preparation of Financial Statements (NEW per AR-C 70)***

AR-C 70 applies:

> *when an accountant in public practice is engaged to prepare financial statements or prospective information and is not engaged to perform an audit, review or compilation engagement on those financial statements or prospective information.*

AR-C 70 may also be applied or adapted as appropriate in the circumstances to the preparation of *other historical financial information*, such as the following:

- Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
- Supplementary information
- Required supplementary information, and
- Pro forma financial information.

That means that a preparation engagement under AR-C 70 may be applied on:

a. Historical financial statements and financial information, and

b. Prospective financial information, such as forecast or projection.

Observation: Prior to the issuance of SSARS No. 21, the guidance for reporting on prospective financial information (a forecast or projection) was found in SSAE No. 10 (AT section 301), Financial Forecasts and Projections. SSAE No. 10 permitted an accountant to perform a compilation, examination, or agreed-upon procedures engagement on prospective financial information. In April 2016, SSAE No. 10 was superseded by SSAE No. 18, Attestation Standards: Clarification and Recodification. With the issuance of SSAE No. 18, a compilation of prospective financial information engagement is officially removed from the SSAEs.

With the issuance of SSARS No. 21, as amended by SSARS No. 23, the authority for an accountant to perform a compilation of prospective financial information (forecast or projection) engagement rests in SSARS No. 21 and not in the SSAE No. 18. Moreover, in new AR-C 70 of SSARS No. 21, a preparation of prospective information engagement is permitted.

The following table summarizes the authority for each type of engagement on prospective financial information:

Authority to Perform Engagement on Prospective Financial Information (1)	
Type of engagement	**Authority**
Preparation of prospective financial information	SSARS No. 21 (2)
Compilation of prospective financial information	SSARS No. 21 (2)
Examination of prospective financial information	SSAE No. 18
Agreed-upon procedures engagement on prospective financial information	SSAE No. 18
(1): Prospective financial information is either a forecast or a projection (2): As amended by SSARS No. 23	

The result is that an accountant who wishes to either prepare or compile prospective financial information follows the guidance found in SSARS No. 21, not SSAE No. 18. Details and guidance as to how to perform a preparation and compilation engagement on prospective financial information is found in the AICPA Guide, *Prospective Financial Information.*

In order for a preparation of financial statements engagement to be subject to AR-C 70, the following elements must exist:

a. The accountant must be *in public practice*[9]

b. The accountant *must be engaged* (hired) by the client to perform a preparation of financial statements or prospective financial information engagement, and

c. There must *not be a corresponding compilation, review or audit engagement* on the prepared financial statements for the same period.

Preparation of financial statements under AR-C 70 versus assisting in preparation of financial statements as a bookkeeping function:

The determination of whether an accountant has been engaged to prepare financial statements (covered by AR-C 70) or merely to assist in preparing financial statements (which is a bookkeeping service that is not subject to AR-C 70), is determined based on services the client requests the accountant to perform, and requires the accountant to apply professional judgment.

The Appendix to AR-C 70, *Preparation of Financial Statements Versus Assistance in Preparing Financial Statements,* provides examples of services that an accountant may be engaged to perform and whether AR-C section 70 would apply.

Engagements to Which a Preparation Engagement under AR-C 70 Applies:

- Preparation of financial statements when the accountant is *not engaged* to perform an audit, review or compilation of such financial statements[10]

- Preparation of financial statements prior to an audit or review (or compilation)[11] by another accountant

- Preparation of financial statements for an entity to be presented alongside the entity's tax return

- Preparation of personal financial statements for presentation alongside a financial plan

- Preparation of a single financial statement, such as a balance sheet or income statement, or financial statements with substantially all disclosures omitted, and

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9 New ethics standards change the term "public accounting" to "public practice."

10 Implicit is that the preparation of financial statements engagement is not performed simultaneously to or at a similar time to the performance of the compilation, review or audit engagement on the same financial statements for the same reporting period.

11 SSARS No. 21 does not include "preparation of financial statements prior to a compilation by another accountant," as an engagement subject to AR-C 70. One reason why the compilation engagement was not included is because it was unlikely that an accountant would prepare financial statements prior to another accountant performing a compilation engagement. Nevertheless, implicit is that the preparation of financial statements prior to another accountant performing an audit, review or compilation engagement, would be subject to AR-C 70.

- Using the information in a general ledger to prepare financial statements outside of an accounting software system

Engagements to Which a Preparation Engagement under AR-C 70 Does Not Apply:

- Preparation of financial statements when the accountant *is engaged to perform an audit, review or compilation* of such financial statements

- Preparation of financial statements with a tax return solely for submission to taxing authorities

- Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant

- Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings

- Financial statements prepared in conjunction with business valuation services

- Bookkeeping services such as:

  - Maintaining depreciation schedules

  - Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases

  - Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

- Drafting financial statement notes

Observation: AR-C 70's requirements for performing a preparation of financial statements engagement apply when an accountant in public practice is engaged (hired) to prepare financial statements as a standalone engagement and the accountant *does not* perform a compilation, review or audit engagement on those same financial statements for the same reporting period. AR-C 70 also applies if the preparation of financial statements engagement is performed prior to the performance of an audit, review or compilation engagement by another accountant or auditor.

If an accountant performs a preparation of financial statements engagement and is also hired to perform an audit, review or compilation engagement on the same financial statements for that same reporting period, AR-C 70 does not apply. Instead, the accountant should follow the guidance found in standards for the compilation, review or audit engagement with no reporting requirement for the preparation service. Regardless of whether a preparation of financial statements engagement is subject to AR-C 70 or not, a preparation of financial statements engagement is a *nonattest service*.

Example 1: Joe Smith CPA is engaged by a client to prepare financial statements for 20X1 (a nonattest engagement) and is not hired to perform a compilation, review or audit engagement on those same financial statements for 20X1.

Conclusion: Joe is performing a preparation of financial statements engagement (a nonattest service) and not performing a compilation, review or audit engagement on those same financial statements. AR-C 70 states that if an accountant is engaged to perform a preparation of financial statements engagement and not engaged to perform an audit, review or compilation of such financial statements, the accountant must follow the standards found in AR-C 70 in performing a preparation of financial statements engagement. Those standards permit an accountant to issue prepared financial statements without a report.

Example 2: Joe Smith CPA is engaged by a client to prepare financial statements (a nonattest service) for 20X1 and is also hired to perform a compilation engagement on those same financial statements for 20X1.

Conclusion: Joe is hired to perform *two engagements*: a preparation of financial statements, and a compilation engagement on the same financial statements for the same period, 20X1. When an accountant is engaged to perform a preparation of financial statements and the accountant *is also engaged* to perform an audit, review or compilation on those same financial statements for that same reporting period, the *AR-C 70 standards do not apply* to the preparation of financial statements engagement. Instead, Joe should follow compilation standards found in AR-C 80 in performing the compilation engagement and issuing a compilation report. The preparation of the compiled financial statements is a nonattest service for which no formal standards apply.

Example 3: Joe Smith CPA is engaged by a client to prepare financial statements (a nonattest service) for 20X1 and is also hired to perform a review engagement on those same financial statements for 20X1.

Conclusion: Joe is hired to *perform two engagements*: a preparation of financial statements and a review engagement on the same financial statements for the same period, 20X1. When an accountant is engaged to perform a preparation of financial statements and the accountant *is also engaged* to perform an audit, review or compilation on those same financial statements for that same period, the AR-C 70 standards do not apply to the preparation of financial statements engagement. Instead, Joe should follow review standards found in AR-C 90 in performing the review engagement and in issuing a review report on those financial statements. The preparation of the reviewed financial statements is a nonattest service for which no formal standards apply.

Example 4: Joe Smith CPA is engaged by a client to prepare financial statements for 20X1 and is also hired to perform an audit engagement on those same financial statements for 20X1.

Conclusion: Joe is hired to *perform two engagements*: a preparation of financial statements, and an audit engagement on the same financial statements for the same period, 20X1. When an accountant is engaged to perform a preparation of financial statements and the accountant *is also engaged* to perform an audit, review or compilation on those same financial statements for that same period, the AR-C 70 standards do not apply to the preparation of financial statements engagement. Instead, Joe should follow the AU-C sections of the auditing standards, in performing the audit engagement. The preparation of financial statements engagement is a nonattest service to which no formal rules apply.

The following chart summarizes the standards that are followed when a preparation of financial statements engagement is prepared alone, or when it is performed in addition to the performance of a compilation, review or audit engagement.

Standards Followed
Preparation of Financial Statements Engagement Performed Along with Compilation, Review or Audit Engagement

TYPE OF ENGAGEMENT PERFORMED				Standards followed	Preparation of FS is a non-attest service
Preparation of financial statements (nonattest service)	**Compilation engagement**	**Review Engagement**	**Audit Engagement**		
√				AR-C 70 Preparation	**YES in all cases**
√	√			AR-C 80-Compilation	
√		√		AR-C 90-Review	
√			√	AU-C sections Auditing Standards	

In looking at the previous chart, a preparation of financial statements engagement is a nonattest service in all cases. The question is which rules should be followed when a preparation engagement is performed. If a preparation engagement is performed by itself, with no compilation, review or audit engagement being performed on the same financial statements for the same period, the accountant must follow the rules found in AR-C 70, which the author discusses further in this course. When, however, a preparation engagement is performed and a compilation, review or audit engagement is also performed on those same financial statements for the same period, the AR-C 70 rules are not followed. Instead, the accountant follows the rules found in AR-C 80 (if a compilation engagement is performed), AR-C 90 (if a review engagement is performed), and the auditing standards found in AU-C sections (if an audit engagement is performed).

What if the accountant performs a preparation engagement and subsequently is asked to perform a compilation, review or audit engagement on the same financial statements for the same period?

AR-C 70 states that the preparation of financial statement standards found in AR-C 70 apply if the accountant is engaged to perform a preparation of financial statements engagement, and *is not engaged* to perform a compilation, review or audit engagement on those same financial statements for the same reporting period. Those AR-C 70 permit an accountant to prepare financial statements without a report and issue them to a third party.

Implicit in an AR-C 70 preparation engagement is that a compilation, review or audit engagement is not performed at the same or a similar time the preparation engagement is performed.

However, there could be instances in which an accountant performs a preparation engagement, and then, sometime in the future, that accountant is asked to perform a compilation, review or audit engagement on those same financial statements for the same period. In such a case, which set of rules apply? This issue is not specifically addressed in AR-C 70.

The author believes that if a preparation engagement is performed, and then in the future, a compilation, review or audit engagement is performed on the same financial statements for the same reporting period, the engagements should be treated as two separate and distinct engagements. The original preparation of financial statements engagement follows the preparation of financial statements standards found in AR-C 70 which is to prepare financial statements without a report for issuance to third parties. Then, when the compilation, review or audit engagement is performed after (but not simultaneously with) the preparation of financial statements engagement, the compilation, review or audit standards apply to that engagement.

Example: Jimmy Fox CPA performs a preparation of financial statements engagement for year ended December 31, 2016 and issues the prepared financial statements on March 31, 2017. On July 1, 2017, the client asks Jimmy Fox to perform a review engagement for December 31, 2016 year end.

Conclusion: The preparation engagement and the review engagement should be treated as two *separate engagements* that follow two sets of standards. The initial preparation engagement follows the AR-C 70 standards for preparation of financial statements. When the review engagement is subsequently performed, Jimmy should follow the review standards found in AR-C 90. The fact that a review engagement is performed for the same period and for the same financial statements for which a preparation engagement is performed, is ignored because the engagements are not performed simultaneously or at a similar time.

Change the facts: Assume instead that both the preparation of financial statements and review engagements are performed simultaneously for 2016.

Conclusion: Because a review engagement is performed at the same time the preparation engagement is performed for the same period (2016), the AR-C 70 standards *do not apply* to the preparation engagement. Instead, the accountant should follow the review standards found in AR-C 90 in performing the review engagement and issuing a review report. The preparation of financial statements is treated as a nonattest service performed for an attest engagement (review engagement).

Why should an accountant care whether a preparation of financial statements engagement is subject to the AR-C 70 standards?

The reality is that the accountant should not really care whether the preparation of financial statements engagement is covered by the AR-C 70 rules or not.

In all cases, the preparation of financial statements is a nonattest service, just like the preparation of a tax return, bookkeeping services, payroll tax services, etc. The only issue is whether that preparation is an engagement to which the accountant must follow the AR-C 70 standards. If the accountant is hired to perform a preparation of financial statements engagement and there is no compilation, review or audit engagement performed on those same financial statements for that same period, then the AR-C 70 standards apply. Once AR-C 70 applies, in performing the preparation of financial statements engagement, the accountant must follow the rules found in AR-C 70 which require the accountant to:

- Obtaining a signed engagement letter for the preparation of financial statements engagement
- Prepare financial statements without a report, and
- Including a "no assurance" legend on each financial statement

These AR-C 70 rules are addressed further on in this section.

If, instead, a preparation of financial statements engagement is performed and the accountant also performs a compilation, review or audit on those same statements, AR-C 70 rules do not apply. Thus, the preparation of financial statements engagement is not subject to any formal rules. In such a case, the accountant must follow the standards pertaining to the compilation, review or audit engagement with no specific standards related to the preparation of financial statements engagement.

What happens if a preparation engagement is performed at interim and a compilation, review or audit engagement is performed for the annual period?

It is common for an accountant to prepare interim financial statements (e.g., monthly or quarterly) and then prepare annual financial statements.

Example: An accountant is hired to prepare monthly financial statements for 11 months. Then, at year end, the accountant is hired to perform a review engagement on the annual financial statements for the bank.

Conclusion:

First, let's look at the services that are being performed. There is:

1. A preparation of financial statements engagement (a non-attest service) on a stand-alone basis performed monthly, for eleven months.

2. An annual review engagement and annual preparation of financial statements.

With respect to the preparation of the eleven monthly financial statements, the AR-C 70 standards apply because for each of those eleven engagements, no compilation, review or audit engagement is performed.

With respect to the annual financial statements, two types of engagements are being performed: a preparation of financial statements (nonattest service) and a review engagement. When an accountant is engaged to perform a preparation of financial statements service and the accountant is also hired to perform a compilation, review or audit engagement on the same financial statements for the same period, the AR-C 70 rules do not apply to the preparation of financial statements. Instead, the accountant should follow the review standards found in AR-C 90 by performing review engagement and issuing a review report.

D. Definitions

The following definitions are used in AR-C 70 (preparation of financial statements, AR-C 80 (compilation engagements) and AR-C 90 (review engagements).

> **Applicable financial reporting framework:** The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

Basic financial statements: Financial statements excluding supplementary information and required supplementary information.

Comparative financial statements: A complete set of financial statements for one or more prior periods included for comparison with the financial statements of the current period.

Financial reporting framework: A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

Generally accepted accounting principles (GAAP): Reference to GAAP in SSARSs means generally accepted accounting principles promulgated by bodies designated by the Council of the AICPA pursuant to the *Compliance with Standards Rule* (AICPA, *Professional Standards*, ET sec. 1.310.001), and the *Accounting Principles Rule* (AICPA, *Professional Standards*, ET sec. 1.320.001), of the AICPA Code of Professional Conduct.

Management: The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Special purpose framework: A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting:

a. **Cash basis:** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).

b. **Tax basis:** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.

c. **Regulatory basis:** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission).

d. **Contractual basis:** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.

e. **Other basis:** A basis of accounting that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash basis, tax basis, regulatory basis, and other basis of accounting are commonly referred to as *other comprehensive bases of accounting* (OCBOA).

Note: Paragraph A4 of AR-C 70 states that certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all the requirements of GAAP. Such frameworks are regulatory-bases of accounting. However, there are instances in which the cash or tax-basis of accounting may be permitted by a regulator. In such cases, the cash and tax bases of accounting are not considered regulatory-bases of accounting.

Those charged with governance: The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of an entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel, for example, executive members of a governance board or an owner-manager.

Definition of special purpose framework

SSARS No. 21 carries over the definition of a special purpose framework found in auditing standards, AU-C 800, *Special Considerations-Audits of Financial Statements Prepared in Accordance with Special purpose frameworks.*

With respect to tax-basis financial statements, SSARS No. 21 makes the following changes like those changes made in AU-C 800:

- The term other comprehensive basis of accounting (*OCBOA)* is replaced with the term *special purpose framework.*

- The definition of income tax basis is changed slightly from the previous one found in SSARS No. 19.

  The SSARS No. 19 definition of income tax basis was "a basis of accounting that the entity uses or *expects to use* to file its income tax return for the period covered by the financial statements." The new definition found in SSARS No. 21 removes the "expects to use" from the definition. As a practical matter, eliminating the "expects to use" from the definition should have no significant effect on the application of SSARS No. 21.

- The term "income tax basis" has been replaced with the term "tax basis."[12]

[12] Although SSARS No. 21 replaces the term "income tax basis" with "tax basis" an accountant is permitted to use either term in the title of the financial statements. Thus, Balance Sheet-Tax Basis and Balance Sheet-Income Tax Basis are both acceptable titles.

E. Summary of a Preparation of Financial Statements Engagement

Before the author addresses the details of AR-C 70 for an engagement to prepare financial statements, let's look at a summary of what a preparation of financial statements engagement is:

a. An accountant performs a preparation of financial statements engagement if he or she is 1) in *public practice*, 2) is *engaged (hired) to prepare financial statements* (e.g., there is an engagement letter to hire the accountant to perform the preparation engagement), and 3) is not engaged (hired) to perform a compilation, review or audit engagement on those same financial statements.

b. A preparation of financial statements engagement is a *nonattest service.*

c. An engagement letter that is signed by both management and the accountant is required.

d. The accountant is not required to be independent nor determine whether he or she is independent.

e. There is generally no report issued with a preparation of financial statements engagement, subject to a disclaimer report exception.

f. The prepared financial statements may be issued to the client or third party without restrictions.

g. The prepared financial statements may omit notes/disclosures.

h. The prepared financial statements may have GAAP/other framework departures.

i. The preparation of financial statements engagement is exempt from peer review in certain cases.

j. There is no separate reporting or disclosure reference to supplementary information in a preparation of financial statements engagement.

The following chart compares the key elements of a preparation engagement with a compilation engagement.

Comparison of Preparation Versus Compilation Engagement

	Compilation Engagement (AR-C 80)	**Preparation of Financial Statements (AR-C 70)**
When does, the standard apply?	When an accountant is engaged to perform a compilation	When an accountant is engaged to prepare financial statements and not engaged to perform a compilation, review or audit on those same financial statements
Must the accountant be in public practice?	Yes	Yes
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	Yes	No
If the accountant is not independent, is that fact required to be disclosed?	Yes	N/A
Does the engagement require a report?	Yes	No[13]
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes
May the financial statements have a departure from the applicable financial reporting framework?	Yes	Yes
Is there any special reporting or reference to supplementary information?	Yes	No
Source: *Developments in Review, Compilation and Financial Statement Preparation Engagements* (AICPA) and AICPA Guide, as modified by the Author.		

[13] In certain cases, a disclaimer report may be required if each page of the prepared financial statements does not include a "no assurance is provided" legend.

A preparation engagement and peer review

An important issue that practitioners want answered is whether a preparation of financial statements engagement, by itself, is subject to peer review.

In August 2014, the AICPA Peer Review Board issued an exposure draft entitled, *PROPOSED CHANGES TO THE AICPA STANDARDS FOR PERFORMING AND REPORTING ON PEER REVIEWS- Preparation of Financial Statements Performed under SSARS and the Impact on the Scope of Peer Review.*

At its January 2015 meeting, the AICPA Peer Review Board voted and approved the exposure draft as a final document with modifications as follows:

a. A CPA firm whose only level of service performed is a preparation of financial statements engagement, is not required to enroll in a peer review program nor to have a peer review performed.

b. If a CPA firm is already enrolled in a peer review program because the firm performs other types of engagements (e.g., compilation, review or audit engagements), any preparation of financial statement engagements would be subject to selection as part of a peer review.

That means that if a firm only performs preparation of financial statement engagements, no peer review would be required.

If, instead, a firm performs compilation, review or audit engagements, and also performs a preparation of financial statements engagement, the firm is already subject to peer review, and the preparation engagement is an engagement that could be selected by a peer reviewer for review.

Example: Hillary is a CPA who performs only five compilation engagements with no footnotes. She performs no review or audit engagements. The compilation reports and financial statements are generally issued to the clients only and not to any banks. Every three years, she must go through a peer review which costs her about $3,500. Hillary believes the peer review is a waste of time and cost because the financial statements are given to the client only and her core business is that of being a tax professional.

Conclusion: Hillary can convert the five compilation engagements to AR-C 70 preparation of financial statements engagements; that is, she can prepare the financial statements and issue them to the client without a report.

More importantly for Hillary, because her only engagements would be AR-C 70 preparation of financial statement engagements (with no compilation, review or audit engagements performed), she can avoid peer review.

Change the facts: Hillary also performs one review engagement.

Conclusion: Too bad for Hillary. That one review engagement means she must go through a peer review. If she converts the five compilation engagements to AR-C 70 preparation of financial statement engagements, she does not avoid peer review and those five preparation engagements are subject to selection by the peer reviewer.

F. General Rules in Applying a Preparation of Financial Statements Engagement Under AR-C 70

Following are the rules that apply to a preparation of financial statements engagement covered by AR-C 70:

1. In addition to complying with the rules in AR-C 70, an accountant is required to comply with the general principles found in AR-C section 60, *General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services.*

2. An accountant must satisfy the *preconditions* found in paragraphs .25 and .26 of AR-C 60 general principles.

   Paragraph .25 of AR-C 60 states that the accountant should not accept an engagement to be performed in accordance with SSARSs if:

   a. The accountant has reason to believe that *relevant ethical requirements* (including independence) will not be satisfied

   b. The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is *not likely to be available or reliable*, or

   c. The accountant has cause to *doubt management's integrity* such that it is likely to affect the performance of the engagement.

   Paragraph .26 of AR-C 60 states that as a condition for accepting an engagement to be performed in accordance with SSARSs, the accountant *should do all the following:*

   a. Determine whether preliminary knowledge of the engagement circumstances indicate that *ethical requirements regarding professional competence* will be satisfied

   b. Determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements *is acceptable*

      1) Factors that are relevant to the accountant's determination that the financial reporting framework selected by management *is acceptable* include the following:

         - Consideration of the nature of the entity
         - The intended purpose of the financial statements
         - The users of the financial statements
           Example: whether they are prepared to meet the common financial information needs of a wide range of users), and
         - Whether law or regulation prescribes the applicable financial reporting framework

         Note: The AICPA Guide states that financial statements prepared in accordance with a special purpose framework may not be suitable for general purposes because the users may not fully understand that particular financial reporting framework.

2) The following general purpose frameworks selected by management are ***presumed to be acceptable*** unless evidence suggests otherwise:

- Accounting principles generally accepted in the United States of America (U.S. GAAP), and
- International Financial Reporting Standards (IFRS).

Note: In addition to the factors previously noted factors, the AICPA Guide offers additional guidance in determining whether a financial reporting framework is "acceptable" which is whether the financial reporting framework exhibits the characteristics of suitable criteria. Suitable criteria exhibit all the following four characteristics:

- Relevance: Criteria are relevant to the subject matter
- Objectivity: Criteria are free from bias
- Measurability: Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter
- Completeness: Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made based on that subject matter

The AICPA Guide notes that the relative importance of each of the four characteristics to a certain engagement should be considered and is a matter of professional judgment. For example, a financial reporting framework may not result in financial statements that meet the objectivity criterion (the are not free from bias), that framework may still be acceptable given the circumstances.

c. Obtain the agreement of management (e.g., engagement letter) that it acknowledges and understands its responsibility:

1) for the selection of the financial reporting framework to be applied in the preparation of financial statements

2) 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

3) for preventing and detecting fraud

4) for ensuring that the entity complies with laws and regulations applicable to its activities

5) for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements

6) to provide the accountant with:

- access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters

- additional information that the accountant may request from management for the engagement

- unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries

If the accountant is not satisfied with any of the matters set out in general principles found AR-C 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the engagement.

3. A preparation of financial statements engagement is subject to the AR-C 70 rules if *three elements are satisfied:*

   - The accountant is in *public practice*

   - The accountant *is engaged* (hired) to perform a preparation of financial statements engagement, and

   - The accountant *is not hired* (engaged) to perform a compilation, review or audit engagement on the same financial statements for the reporting period.

4. The preparation of financial statements is a *nonattest service.*

5. The accountant *is not required to determine whether the accountant is independent* to perform a preparation of financial statements engagement under AR-C 70.

   Note: Although an accountant is not required to be independent to perform a preparation of financial statements engagement, the accountant must be careful when he or she prepares financial statements (a nonattest service) for an interim period and then performs a compilation, review or audit engagement at annual year end.

   The *Nonattest Services* subtopic of the "*Independence Rule*" (found in the AICPA Professional Standards, ET sec. 1.295) addresses the accountant’s considerations with respect to independence when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and also be engaged to perform an attest service (an audit, review, or compilation engagement) with respect to the annual financial statements. The performance of the preparation services for an attest engagement may impair independence unless three safeguards are met.

   Those three safeguards, which are discussed further on in the review section of this course, require that:

a. The client must agree to assume all management responsibilities for the preparation of financial statements service

b. The accountant must not assume responsibilities for the preparation of financial statements service, and

c. There must be language in the engagement letter that confirms that the client, not the accountant, assumes management responsibility for the nonattest service performed (e.g., preparation of financial statements).

6. In preparation of financial statements engagement, the accountant is *not required to verify the accuracy or completeness of the information* provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

7. The accountant should obtain an agreement of management (engagement letter) *signed by both the accountant and management*.

8. The accountant should obtain an understanding of:

- the applicable financial reporting framework, and

- the significant accounting policies intended to be used in the preparation of the financial statements.

Note: AR-C 70 states that the requirement for the accountant to obtain an understanding of the financial reporting framework adopted by management and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain the required understanding from various sources. For example, such sources may include consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry.

G. Specific Rules for Preparing Financial Statements per AR-C 70

AR-C 70 provides specific rules that must be followed if an accountant performs a preparation of financial statements engagement:

1. The accountant should prepare the financial statements using the records, documents, explanations, and other information provided by management.

2. The accountant *does not include a report* with the prepared financial statements subject to the disclaimer report exception noted below.

3. Because a report is not included with the prepared financial statements, the accountant should ensure that a legend is included on each page of the financial statements indicating, at a minimum, that ***"no assurance is provided"*** on the financial statements.

Note: AR-C 70 states that the ***"no assurance is provided"*** statement (legend) on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements.

Because the financial statements are the responsibility of management, the "no assurance" statement (legend) is made at management's discretion, and the accountant or the accountant's firm name is not required to be included within that legend.

SSARS No. 21 offers two examples of a legend that should be included on each page of the financial statements as follows:

> *"No assurance is provided on these financial statements."   or*
>
> *"These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them."*

Other legends would also be acceptable, as long as they convey that no assurance is provided on the financial statements would also be acceptable. The AICPA Guide offers the following additional options for legends that are acceptable:

> *"No assurance is provided by ABC CPAs on these financial statements."*
>
> *"ABC CPAs did not perform an audit, review, or compilation engagement on these financial statements, and no assurance is provided on them."*
>
> *"ABC CPAs adhered to Statement on Standards for Accounting and Review Services (SSARS) No. 21 issued by the American Institute of Certified Public Accountants in the preparation of these financial statements. No assurance is provided on these financial statements."*

Observation: As the reader can see, there are several options in selecting a legend format ranging from the "no assurance is provided…" version, to an elaborate version that includes the identity of the CPA firm. The key is that the legend specifically should state that no assurance is provided on the financial statements. The accountant is not precluded from including the accountant's firm name in the legend although to do so, explicitly links the accountant to the financial statements. The author suggests that the simplest version "no assurance is provided on these financial statements" is the best and most practical choice because it conveys a cleaner and concise message.

4. If the accountant is unable to include a "no assurance is provided" legend on each page of the financial statements, the accountant should:

- Issue a disclaimer report that makes clear that no assurance is provided on the financial statements

- Perform a compilation engagement in accordance with AR-C 80, *Compilation Engagements*, or

- Withdraw from the engagement.[14]

An example of a disclaimer report that the accountant may issue in a preparation of financial statements engagement follows:

> To Management and Board of Directors
> XYZ Company
>
> The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, <u>were not subjected to an audit, review, or compilation engagement</u> by me (us) and, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.
>
> Signature of accounting firm or accountant
> Accountant's city and state

Observation: The financial statements belong to the client, not the accountant. Therefore, there could be rare instances in which the client does not want a legend such as "no assurance is provided" placed on each pages of prepared financial statements. There also may be instances in which the "no assurance is provided" legend cannot be placed on the pages because of software limitations.

In such cases, the accountant cannot force the client to add the legend because the financial statements do not belong to the accountant. Therefore, the accountant can issue a disclaimer report to notify the user that no assurance is provided with respect to the financial statements.

5. When preparing financial statements in accordance with a special purpose framework (such as tax basis), the accountant should include a <u>*description of the financial reporting framework on the face of the financial statements or in a note to the financial statements*</u>.

Example:

XYZ Company
Balance Sheet-**Tax Basis**
December 31, 20X1

Note: SSARS No. 21 states that a description of the special purpose framework is usually placed either:

- Next to the title of the financial statements (example: balance sheet- tax basis), or
- Under the title of the financial statements.

However, the description may be placed elsewhere in the financial statements.

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[14] The option to withdraw from the engagement was added to SSARS No. 21 by SSARS No. 23.

Does the fact that a financial statement title includes the special purpose framework in its title (e.g., tax basis), satisfy the requirement to include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements?

Yes. Paragraph A13 of SSARS No. 21 states that the description can be in the form of a suffix "next to or under the title of the financial statements." Thus, as long as the financial statement title includes a suffix such as "Balance Sheet-Tax Basis" the suffix "tax basis" satisfies the requirement to include a description of the framework either on the face of the financial statement or in a note.

The preferred approach to including a description of the special purpose framework is to include it in the title as follows:

XYZ Company
Balance Sheet-**Tax Basis**
December 31, 20X1

XYZ Company
Statement of Income-**Tax Basis**
December 31, 20X1

Paragraph A13 also allows for the description to be placed under the title, or elsewhere on the face of the financial statements in an accompanying note. As a practical point, placing the description in a suffix to the financial statement title such as "Statement of Income-Tax Basis" is the best presentation approach. Moreover, the suffix "income tax basis" may be used instead of "tax basis."

6. If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so that management understands the significant judgments reflected in the financial statements and accepts responsibility for those judgments.

   Examples of situations in which an accountant may provide assistance to management include:

   - Advising management on alternative accounting policies that are significant to the financial statements, or

   - Helping management with significant judgments regarding material accounting estimates.

   The accountant may wish to document significant consultations or significant judgments regarding amounts or disclosures to be reflected in the financial statements.

7. If the accountant becomes aware that the records, documents, explanations, or other information, including significant judgments, used in the preparation of the financial statement are incomplete, *inaccurate, or otherwise unsatisfactory*, the accountant should bring that to the attention of management and request additional or corrected information.

   Observation: AR-C 70 carries over from the compilation standards (AR-C 80) the language related to "incomplete, inaccurate, or otherwise unsatisfactory" documents or information. If an accountant discovers incomplete, inaccurate or otherwise unsatisfactory information during the engagement, the accountant must bring that information to the attention of management and request that management correct the information. What this means is that in performing a preparation of financial statements engagement, an accountant has the same responsibility as an accountant who performs a compilation engagement. That is, if there is a material item that comes to the accountant's attention, he or she must address it and request that management correct it. The fact that an accountant is performing a preparation engagement is not a defense against not researching a potentially material misstatement.

8. When, after discussions with management, the accountant prepares financial statements that contain a *known departure(s)* from the applicable financial reporting framework (including inadequate disclosure), the accountant should *disclose the material misstatement(s)* in the financial statements.

   The disclosure of a material misstatement or misstatements may be made either:

   - On the face of the financial statements, or
   - In a note to the financial statements

   Following is an example of a disclosure:

"The financial statements do not include a statement of cash flows which is required under generally accepted accounting principles in the United States."

or

"The financial statements do not include a statement of cash flows."

9. When, after discussions with management, the accountant prepares financial statements that *omit substantially all disclosures* required by the applicable financial reporting framework, the accountant should disclose such omission in the financial statements.

   The disclosure of the omission of substantially all disclosures required by the applicable financial framework may be made *on the face of the financial statements or in a note to the financial statements.*

   Example of a disclosure that may be presented on the face of the financial statements (at the top or bottom of the financial statement page) or in the note to the financial statements follows:

"Substantially all disclosures required by accounting principles generally accepted in the United States are not included."

or

“Substantially all disclosures required by GAAP omitted.”

   Note: The accountant should not prepare financial statements that omit substantially all disclosures required by the applicable financial reporting framework if the accountant becomes aware that the omission of substantially all disclosures was undertaken with the intention of misleading users of such financial statements.

Observation: If the financial statements omit substantially all disclosures, SSARS No. 21 requires that a disclosure of that fact be made either on the face of each financial statement or in an accompanying note. Typically, it will be made on the face of the financial statements because there usually are no notes to financial statements in a preparation of financial statements engagement.

Where should the disclosure that the financial statements omit substantially all disclosures be made on the face of the financial statements?

There are essentially <u>two options</u>:

Option 1: At the top of each page under the financial statement title, or
Option 2: At the bottom of each page of the financial statements

Following are sample presentations of each option:

Option 1: At the top of each page of the financial statements:

XYZ Company
Balance Sheet
December 31, 20X2
Substantially All Disclosures
Required by GAAP Omitted

Option 2: At the bottom of each page of the financial statements:

XYZ Company
Balance Sheet
December 31, 20X2

ASSETS	
Total Assets	$XX
LIABILITIES AND EQUITY	
Liabilities	$XX
Equity	XX
Total liabilities and equity	$XX

Substantially all disclosures required by GAAP omitted.
or

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

10. If the prepared financial statements include supplementary information, there is no separate disclosure or other reporting reference to that supplementary information.

Combination of no statement of cash flows and substantially all disclosures omitted

In most instances, accountants who perform a preparation of financial statements engagement will prepare financial statements that omit the statement of cash flows and substantially all disclosures.

The prepared financial statements will typically consist of three pages and no footnotes as follows:

- Balance sheet
- Statement of income
- Schedule of operating expenses[15]

If this is the case, the legend on each of the three pages would consist of the following three components:

1. ***"No assurance is provided on these financial statements."***

2. ***"The financial statements do not include a statement of cash flows."***

3. ***"Substantially all disclosures required by GAAP omitted."***

Note: Technically, the schedule of operating expenses is not a financial statement and the legends that are required to be placed on each page of the financial statements do not have to be placed on the schedule. The author suggests that an accountant treat the schedule of operating expenses and any other supplementary information "as if" it was a financial statement. In doing so, the accountant would include legends on each page of the supplementary information even though it is not required.

Is an accountant permitted to include in a disclaimer report, the disclosure about the GAAP departure and/or omission of disclosures?

No. AR-C 70 requires that a disclosure be presented *either* on the face of the financial statements or in the notes to financial statements in *two instances*:

- There is a GAAP (or other framework) departure, or
- Substantially all disclosures are omitted.

AR-C 70 provides that if there is a GAAP (or other financial reporting framework) departure and/or substantially all disclosures are omitted, the accountant must ensure that a disclosure (legend) is made either on the face of the financial statements or in the notes to those financial statements.

A disclaimer report is required if a client refuses to include on each page of the financial statements a legend, *"no assurance is provided on these financial statements"* or similar language.

There is no authority within AR-C 70 that permits an accountant to include in a disclaimer report, a disclosure of a GAAP (or other framework) departure or omission of substantially all disclosures.

[15] Alternatively, the schedule of operating expenses might be omitted with all operating expenses shown in detail on the statement of income.

Is the accountant permitted to include any required legends in a note to the prepared financial statements instead of including the legends on the pages of the prepared financial statements?

AR-C 70 permits some, but not all, of the required legends to be included in a note instead of on the face of the financial statements.

Location of Legends on Prepared Financial Statements- AR-C 70	
Legend	**Location per AR-C 70**
"No assurance is provided on these financial statements."	Must be presented on each page of the financial statements
GAAP departure such as: "The financial statements do not include a statement of cash flows."	Must be presented either on a) each page of the financial statements or b) in an accompanying note to the financial statements
"Substantially all disclosures required by GAAP omitted."	Must be presented either on a) each page of the financial statements or b) in an accompanying note to the financial statements
Special purpose framework only (e.g., tax basis)	
Description of the special purpose Framework (e.g., tax basis)	Must be presented either on a) the face of each financial statement, or b) in an accompanying note to the financial statements.

In looking at the previous chart, prepared financial statements must have a legend such as 'no assurance is provided on the financial statements." That legend must be presented on each page of the prepared financial statements. It cannot be presented in a separate note to the financial statements.

Conversely, GAAP departures (such as no statement of cash flows is presented) and substantially all disclosures are omitted, may be presented either on each page of the prepared financial statements, or in an accompanying note to the financial statements.

The author believes the most effective place to present all the legends is on each page of the financial statements to avoid having to attach a separate note to financial statements page.

Moreover, if an accountant is using a special purpose framework, such as tax basis, a description of the special purpose framework must be presented either on the face of each financial statement or in an accompanying note. Again, the author believes that the description should be presented on the face of each financial statement as a suffix such as "balance sheet-tax basis" to avoid having to include a note to financial statements page.

Is an accountant permitted to include disclosures about only a few matters?

SSARS No. 21 carries over from SSARS No. 19 the mechanism by which financial statements include disclosures only _about a few matters_.

The accountant may prepare financial statements that include disclosures only about a few matters in the notes to the financial statements. Such disclosures may be labeled:

"Selected Information—Substantially All Disclosures Required By GAAP [or another the applicable financial reporting framework] Are Not Included."

If the above disclosure is included on each page of the notes pages, there is no requirement to include an additional disclosure stating that substantially all disclosures required by GAAP are not included.

When the financial statements include more than a few disclosures (e.g., more than two or three disclosures), the above disclosure is not appropriate. Instead, the omission of one or more notes, when all other disclosures are presented, should be treated as a GAAP departure.

Should there be any reference to supplementary information in prepared financial statements?

No. AR-C 70 does not require that there be any special legend or other reporting requirements with respect to any supplementary information that might be included in prepared financial statements.

Paragraph 2 of AR-C 70 states that the preparation of financial statements standards may also be applied to the preparation of other historical or prospective financial information that includes supplementary information, including required supplementary information.

However, the AR-C 70 standard applies to the preparation of financial statements, not supplementary information. Thus, if a preparation engagement is performed on financial statements and supplementary information is also included, such as a schedule of operating expenses, the rules found in AR-C 70 do not have to be applied to that supplementary information. That means there is no requirement that each page of the supplementary information have a "no assurance" legend. That said, the author suggests that an accountant add the "no assurance" language to any schedules of supplementary information, even though not required.

Legends when there are tax-basis financial statements

If an accountant prepares financial statements under a special purpose framework, such as tax-basis financial statements, the legends that are required to be placed on each page of the financial statements differ from the legends required for GAAP statements.

a. _No assurance is provided on these financial statements_: Is required for all financial statements, including those prepared on the tax basis.

b. _The statement of cash flows is not included:_ No legend is required because a statement of cash flows is not required under the tax-basis of accounting.

c. <u>Substantially all disclosures are omitted:</u> The legend must be modified to state that:

> *"Substantially all disclosures <u>ordinarily included</u> in financial statements prepared on the tax-basis of accounting are not included."*

The following chart compares the required legends for U.S. GAAP versus tax-basis financial statements.

Comparison of Legends Required for GAAP Versus Tax-basis financial statements		
Legend	**GAAP Financial Statements**	**Tax Basis Financial Statements**
Standard "no assurance disclaimer"	*"No assurance is provided on these financial statements."*	*"No assurance is provided on these financial statements."*
No statement of cash flows presented (GAAP departure)	*"The financial statements do not include a statement of cash flows"*	NA No legend is required[16]
Substantially all disclosures omitted	*"Substantially all disclosures <u>required by</u> accounting principles generally accepted in the United States are not included."*	*"Substantially all disclosures <u>ordinarily included</u>[17] in financial statements prepared in accordance with the tax-basis of accounting are not included."*

Preparing Prospective Financial Information

AR-C 70 authorizes an accountant to perform a preparation engagement on prospective financial information, such as a forecast or projection:

SSARS No. 23 amends SSARS No. 21 to provide the following general requirements when an accountant performs a preparation engagement on prospective financial information:

1. ***An accountant should not prepare prospective financial information that excludes disclosure of the summary of significant assumptions.***[18]

2. ***If an accountant is performing a financial projection, the accountant should not prepare a financial projection that excludes either:***

16 A statement of cash flows is required only for GAAP financial statements. Thus, the omission of a statement of cash flows in tax-basis financial statements is not a departure.

17 With respect to tax-basis financial statements, the term "ordinarily included" replaces the term "required" because there are no specific disclosures codified for tax-basis financial statements.

18 SSAE No. 18 provides guidance on the summary of significant assumptions.

- ***an identification of the hypothetical assumptions, or***
- ***a description of the limitations on the usefulness of the presentation.***

Note: SSARS No. 23 states that if an accountant is engaged to prepare prospective financial information, any references in SSARS No. 21 to the term *financial statements* are to be taken as a reference to the term *prospective financial information***.**

The new edition of the AICPA Guide, *Prospective Financial Information*, provides comprehensive guidance regarding prospective financial information and establishes the preparation and presentation guidance for financial forecasts and financial projections.

Information on prospective financial information is found in the AICPA Guide as follows:

Chapter 6, *Preparation Guidelines*
Chapter 7, *Reasonably Objective Basis*
Chapter 8, *Presentation Guidelines*, and
Chapter 9, *Illustrative Prospective Financial Statements*.

The AICPA Guide also includes information about the types and uses of prospective financial information and suitable criteria for the preparation and presentation of prospective financial information.

The accountant is not prohibited from preparing prospective financial information prepared and presented in accordance with other suitable criteria.

H. Documentation in a Preparation Engagement

The accountant should prepare documentation about each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following:

a. The engagement letter or other suitable form of written documentation with management

b. A copy of the financial statements that the accountant prepared

c. If applicable, documentation regarding significant consultations or significant judgments regarding amounts or disclosures to be reflected in the financial statements, and

d. If applicable, if the accountant departs from a relevant presumptively mandatory requirement, documentation of the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

Observation: Typically, the only two items that an accountant must document in a preparation of financial statements engagement will be an engagement letter, and a copy of the prepared financial statements, identified as items (a) and (b), respectively, above. It will be unusual for items (c) and (d) to apply as they are both non-recurring events.

I. Engagement Letter- Preparation of Financial Statements Engagement

As a condition for accepting an engagement to prepare financial statements, in addition to the precondition requirements in paragraphs .25 and .26 of AR-C 60, the accountant should obtain the agreement with management. That agreement *must be in writing and must be signed by both the accountant and management.*

AR-C 70 provides the following guidance for an accountant to obtain agreement on the engagement terms:

1. The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate.

    a. When the agreement on the terms of engagement is only with those charged with governance, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities.

    b. When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing to the terms of the engagement with management of the entity is necessary to establish that the preconditions for an engagement to prepare financial statements are present.

2. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement between the parties and should include the following:

    a. The objective of the engagement

    b. The responsibilities of management set forth in paragraph .26 of AR-C section 60

    c. The agreement with management that either:

        - each page of the financial statements will include a statement (legend) indicating that "*no assurance*" is provided on the financial statements, or

        - the accountant will be required to issue a disclaimer report that makes clear that no assurance is provided on the financial statements.

    d. The responsibilities of the accountant

    e. The limitations of the engagement to prepare financial statements

    f. Identification of the applicable financial reporting framework for the preparation of financial statements

    g. Whether the financial statements are to:

        - contain a known departure(s) from the applicable framework, or

        - omit substantially all disclosures required by the applicable financial reporting framework

3. The engagement letter or other suitable form of written agreement should be _signed by both_:

   a. the accountant or the accountant's firm, and

   b. management or those charged with governance.

   Note: The previous rules found in SSARS No. 19 required an accountant to obtain an understanding in writing of the terms and conditions of the engagement. However, SSARS No. 19 did not require that the engagement letter be signed by the accountant and the client. Now, SSARS No. 21 requires that the letter be signed by _both_ the accountant and management or those charged with governance.

   The understanding with management regarding the services to be performed for engagements to prepare financial statements is required to be in a documented form. Accordingly, an oral[19] understanding is insufficient. An engagement letter is the most common and usually the most convenient method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements.

[19] SSARS No. 23 amends SSARS No. 21 to replace the term "verbal" with "oral."

J. Exhibit —Illustrative Engagement Letters - Preparation Engagement

The following is an example of an engagement letter for an accountant to prepare financial statements. This sample letter is extracted from AR-C 70 of SSARS No. 21 and the AICPA Guide, and modified by the author. This engagement letter is not authoritative but is intended as an illustration.

Illustrative Engagement Letter- Preparation of Financial Statements Engagement- U.S. GAAP- Substantially All Disclosures and the Statement of Cash Flows Omitted

CPA Firm Letterhead

To the appropriate representative of ABC Company:(1)

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, and changes in stockholders' equity for the year then ended. **These financial statements will not include a statement of cash flows and related notes to the financial statements**. (2)

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (3)

We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities
The objective of our engagement is to *prepare financial statements in accordance with accounting principles generally accepted in the United States of America* based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Management Responsibilities
The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is the preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARSs:

a. The selection of the financial reporting framework to be applied in the preparation of financial statements
b. 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
c. The prevention and detection of fraud
d. To ensure that the entity complies with the laws and regulations applicable to its activities
e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
f. To provide us with:
   - Access to all information of which you are aware that is relevant to the preparation and presentation of the financial statements, such as records, documentation, and other matters
   - Additional information that may be requested for the purpose of the preparation of the financial statements, and
   - Unrestricted access to persons within the Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

The financial statements will not include a statement of cash flows and substantially all disclosures required by accounting principles generally accepted in the United States of America. You agree that the financial statements will clearly indicate that the statement of cash flows and substantially all required disclosures are omitted.

[If the accountant expects to issue a disclaimer report, instead of the preceding paragraph, the following may be added]:

> **As part of our engagement, we will issue a disclaimer [report] that will state that the financial statements were not subjected to an audit, review or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.**

Other relevant information

Our fees for these services . . . .

[*The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements]:*

> *"You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us."*

If you request us to perform additional services not contemplated or described in this engagement letter, we will provide you with a separate agreement describing those additional services and fees.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

____
[*Signature of accountant or accountant's firm*] (4)

Acknowledged and agreed on behalf of ABC Company by:

________________________ (4)
[*Signed*]

[*Name and title*]________________________
[*Date*]

(1): The addresses and references in the engagement letter should be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons.

(2): In most cases, the preparation of financial statements will omit both a statement of cash flows and substantially all disclosures. In such a situation, an additional sentence may be added stating:

> *"These financial statements will not include a statement of cash flows and related notes to the financial statements."*

If, instead, a statement of cash flows and substantially all disclosures are included, the first paragraph would read as follows:

> *"You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, and changes in stockholders' equity, and <u>cash flows</u> for the year then ended and <u>the related notes to the financial statements</u>."*

(3): If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement letter. Alternatively, the additional nonattest services could be included in a separate engagement letter.

(4): Engagement letter must be signed by both management (or those charged with governance) and the accountant.

Illustrative Engagement Letter- Preparation of Financial Statements Engagement- Tax-basis of accounting

CPA Firm Letterhead

To the appropriate representative of ABC Company:(1)

You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet-tax basis as of December 31, 20XX, and the related statement of income and retained earnings-tax basis equity for the year then ended. **These financial statements will not include a statement of cash flows- tax basis and related notes to the financial statements**. (2)

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (3)

We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

Our Responsibilities
The objective of our engagement is to *prepare financial statements in accordance with the tax-basis of accounting* based on information provided by you. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, or provide any assurance on the financial statements.

Our engagement cannot be relied upon to identify or disclose any financial statement misstatements, including those caused by fraud or error, or to identify or disclose any wrongdoing within the entity or noncompliance with laws and regulations.

Management Responsibilities
The engagement to be performed is conducted on the basis that management acknowledges and understands that our role is the preparation of the financial statements in accordance with the tax-basis of accounting. Management has the following overall responsibilities that are fundamental to our undertaking the engagement to prepare your financial statements in accordance with SSARSs:

a. The selection of the tax-basis of accounting as the financial reporting framework to be applied in the preparation of financial statements
b. 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
c. The prevention and detection of fraud
d. To ensure that the entity complies with the laws and regulations applicable to its activities

e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements

f. To provide us with:
  - Access to all information of which you are aware that is relevant to the preparation and presentation of the financial statements, such as records, documentation, and other matters
  - Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - Unrestricted access to persons within the Company of whom we determine necessary to communicate.

The financial statements will not be accompanied by a report. However, you agree that the financial statements will clearly indicate that no assurance is provided on them.

The financial statements will not include substantially all disclosures ordinarily included in financial statements prepared on the tax-basis of accounting. You agree that the financial statements will clearly indicate that substantially all disclosures ordinarily included are omitted.

[If the accountant expects to issue a disclaimer report, instead of the preceding paragraph, the following may be added]:

> As part of our engagement, we will issue a disclaimer [report] that will state that the financial statements were not subjected to an audit, review or compilation engagement by us and, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them.

Other relevant information

Our fees for these services . . . .

[*The accountant may include language, such as the following, regarding limitation of, or other arrangements regarding, the liability of the accountant or the entity, such as indemnification to the accountant for liability arising from knowing misrepresentations to the accountant by management (regulators may restrict or prohibit such liability limitation arrangements]:*

> *"You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us."*

If you request us to perform additional services not contemplated or described in this engagement letter, we will provide you with a separate agreement describing those additional services and fees.

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our engagement to prepare the financial statements described herein, and our respective responsibilities.

Sincerely yours,

____

[*Signature of accountant or accountant's firm*] (4)

Acknowledged and agreed on behalf of ABC Company by:

______________________ (4)

[*Signed*]

[*Name and title*]______________________

[*Date*]

(1): The addresses and references in the engagement letter should be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons.

(2): In most cases, the preparation of financial statements will omit both a statement of cash flows and substantially all disclosures. In such a situation, an additional sentence may be added stating:

> *"These financial statements will not include a statement of cash flows-tax basis and related notes to the financial statements."*

If, instead, a statement of cash flows and substantially all disclosures are included, the first paragraph would read as follows:

> *"You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet-tax basis as of December 31, 20XX, and the related statements of income and retained earnings-tax basis, <u>and cash flows- tax basis</u> for the year then ended <u>and the related notes to the financial statements</u>."*

(3): If additional nonattest services are to be performed, such as preparation of tax returns and/or bookkeeping services, reference to such services can be made in the beginning or the end of the engagement letter. Alternatively, the additional nonattest services could be included in a separate engagement letter.

(4): Engagement letter must be signed by both management and the accountant.

K. Illustrative Financial Statements -AR-C 70

On the following pages, the author has included examples of financial statements that encompass the preparation of financial statements standards under AR-C 70.

Example 1: Preparation of GAAP Financial Statements - Full Set of Financial Statements and Disclosures

Facts:

- An accountant is engaged to prepare a full set of financial statements and disclosures for XYZ Company.
- No schedule of operating expenses or other supplementary information is prepared.
- No compilation, review or audit engagement is performed on the financial statements.

Conclusion: A full set of financial statements would be prepared including all related notes.

In this example, the author has included only the balance sheet and income statement. A statement of cash flows and all related notes to financial statements should be presented.

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.

Other statement and disclosures included but not presented here:

The author has not presented the statement of cash flows and notes to financial statements even though they are required in this example.

Example 2: Preparation of Financial Statements – Disclaimer Report Issued- No Legend on Financial Statement Pages

Facts:

- Same facts as Example 1 except that the client does not place a legend on each page of the financial statements indicating: *"No assurance is provided on these financial statements."*
- A disclaimer report is issued by the accountant because there is no legend on each page of the financial statements.

Sample Disclaimer Report:

> To: Board of Directors and Management[20]
> XYZ Company
>
> The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20X2 and 20X1, were not subjected to an audit, review, or compilation engagement by me (us) and, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.
>
> Signature of accounting firm or accountant
> Accountant's city and state

[20] There is no requirement that the accountant include a greeting/salutation in the disclaimer report. The author includes it because he believes it would be appropriate to include the salutation in a disclaimer report issued.

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

Other statement and disclosures included but not presented here:

The author has not presented the statement of cash flows and notes to financial statements even though they are required in this example.

Observation- Example 2: Notice in Example 2, a disclaimer report is issued because the "no assurance" legend is omitted from each page of the financial statements.

Example 3: Preparation of Financial Statements – Special Purpose Framework (Tax Basis)

Facts: An accountant is engaged to prepare a full set of financial statements and disclosures for XYZ Company. A tax basis framework is used.

Conclusion: A full set of financial statements would be prepared including all related notes, based on the tax-basis of accounting.

In this example, the author has included only the balance sheet and income statement. All related notes to financial statements should be presented. A statement of cash flows would not be presented as it is not required unless GAAP financial statements are presented.

XYZ Company
Balance Sheets-**Tax Basis (1)**
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.

XYZ Company
Statements of Income and Retained Earnings- **Tax Basis (1)**
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.

Note: In addition to a balance sheet and income statement, a full set of notes to financial statements would also be included. A statement of cash flows would not be required because tax-basis financial statements do not require that a statement of cash flows be included.

(1): When a special purpose framework is used such as tax-basis financial statements, a description of the framework must be presented either on the face of the financial statements or in the notes. In this example, one way in which it can be disclosed on the face of the financial statements is to include it in the suffix to the title, such as *"balance sheet-tax basis."*

Example 4: Preparation of GAAP Financial Statements – No Statement of Cash Flows and Substantially All Disclosures Omitted

Facts:

- An accountant is engaged to prepare a GAAP balance sheet, income statement and schedule of operating expenses.
- The client does not want a statement of cash flows (GAAP departure) and omits substantially all disclosures.

Conclusion: GAAP statements should be prepared with the following:

- Legend on each page stating there is "*no assurance*"
- Legend on each page of the financial statements for the GAAP departure (no statement of cash flows)
- Legend on each page of the financial statements noting that substantially all disclosures are omitted.

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

XYZ Company
Schedules of Operating Expenses
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rent	$XX	$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	$XX	$XX
	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

Observation: Example 4 represents what is likely the most common format for a preparation of financial statements engagement under AR-C 70. In Example 4, the accountant prepares a balance sheet, income statement and schedule of operating expenses, but no statement of cash flows and no disclosures.

AR-C 70 states that there is no requirement to place any legends on schedules of supplementary information. The author recommends that an accountant include on schedules of supplementary information (such as a schedule of operating expenses), the same legends that are required for financial statements.

Example 4A: Preparation of GAAP Financial Statements – No Statement of Cash Flows and Substantially All Disclosures Omitted- Legends Placed in a Note

Facts:

- An accountant is engaged to prepare a GAAP balance sheet, income statement and schedule of operating expenses.
- The client does not want a statement of cash flows (GAAP departure) and omits substantially all disclosures.
- The accountant wants to include any legends in a separate note to the prepared financial statements.

Conclusion: GAAP statements should be prepared with the following:

- Legend on each page stating there is "*no assurance is provided on these financial statements.*"
- The financial statements should have a separate note page that includes two legends: 1) No statement of cash flows is presented, and 2) Substantially all disclosures are omitted.

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.

XYZ Company
Schedules of Operating Expenses
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rent	$XX	$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	$XX	$XX
	$XX	$XX

No assurance is provided on these financial statements.

XYZ Company
Note to Prepared Financial Statements
Years Ended December 31, 20X2 and 20X1

1. The financial statements do not include a statement of cash flows.

2. Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

No assurance is provided on these financial statements.

Observation: The author believes that Example 4A is not the best way in which to present prepared financial statements. In this example, two of the required legends are presented in an attached note to prepared financial statements instead of being presented on each page of the financial statements. If an accountant prepares financial statements that omit the statement of cash flows and substantially all disclosures, the best presentation is to include the two legends on each page of the prepared financial statements and avoid having to include them in a separate note page.

Example 5: Preparation of Tax-Basis Financial Statements – No Statement of Cash Flows is Presented and Substantially All Disclosures Omitted

Facts:

- An accountant is engaged to prepare financial statements for XYZ Company on the tax-basis of accounting.
- The client does not want a statement of cash flows and wants to omit substantially all disclosures.
- A schedule of operating expenses is included.

Conclusion:

Tax-basis financial statements would be prepared with the following:

- Statement (legend) on each page stating there is "no assurance."
- Disclosure (legend) on each page of the financial statements noting that substantially all disclosures "ordinarily included" in tax-basis financial statements are omitted.
- No disclosure (legend) is required for not having a statement of cash flows because such a statement is not required unless GAAP statements are issued.

XYZ Company
Balance Sheets- **Tax Basis**
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders’ equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	$XX	$XX

No assurance is provided on these financial statements. Substantially all disclosures ordinarily included in financial statements prepared on the tax-basis of accounting are not included.

XYZ Company
Statements of Income and Retained Earnings- **Tax Basis**
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.
Substantially all disclosures ordinarily included in financial statements prepared on the tax-basis of accounting are not included.

XYZ Company
Schedules of Operating Expenses- **Tax Basis**
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rent	$XX	$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.
Substantially all disclosures ordinarily included in financial statements prepared on the tax-basis of accounting are not included.

Observation: In Example 2, no statement of cash flows is required for tax-basis financial statements, although such a statement could be included in a set of financial statements. Thus, the fact that there is no statement of cash flows is not a departure from the tax-basis of accounting that requires a legend on the bottom of each page of the financial statements.

Note also the language in the legend "substantially all disclosures ordinarily included…" The term "ordinarily included" is used in lieu of "required" because there is no formal codification of specific disclosures required for tax-basis financial statements.

Is an accountant permitted to use a disclaimer report and include a legend on each page of the financial statements stating "See Disclaimer Report"?

Some accountants are uncomfortable with issuing prepared financial statements without a report. Therefore, they want to issue a disclaimer report regardless of whether one is required. SSARS No. 21 explicitly states that a disclaimer (report) is required only when prepared financial statements do not include a legend such as "*no assurance is provided on these financial statements*." In such an instance, many accountants are uncomfortable with issuing financial statements that have no legend on each page of the financial statements.

The question is whether an accountant is permitted to issue a disclaimer report and add a legend on each page of the financial statements such as: *"See Disclaimer Report." or "See Accountant's Disclaimer Report."* SSARS No. 21 is silent on the matter. Therefore, the author believes there is nothing that precludes an accountant from adding a *"See Disclaimer Report"* or "*See Accountant's Disclaimer Report*" legend while also issuing a disclaimer report. Although the ARSC did not provide for use of the disclaimer report as a normal event, it may be that more practitioners will use the disclaimer report along with a "See Disclaimer Report" legend as their approach to performing preparation of financial statement engagements under AR-C 70.

As the reader may observe, there are nuances in performing a preparation of financial statements engagement under AR-C 70 that lead to the real question which is: Why doesn't the accountant simply issue a compilation report and avoid performing a preparation of financial statements engagement?

One reason is the fact that, for some practitioners, preparation engagements may not be subject to peer review. For some accountants who might perform only preparation of financial statement engagements, changing to a compilation engagement means the accountant would be subject to peer review. Instead, by issuing preparation of financial statement engagements only, the accountant may not be subject to peer review.

Following is a non-authoritative example of a situation in which an accountant chooses to issue a disclaimer report and adds a legend to each page of the financial statements *"See Disclaimer Report."*

Example 6: Preparation of Financial Statements–Disclaimer Report Issued- an Optional Disclaimer Legend on Financial Statement Pages

Facts:

- No legend is presented on each page of the financial statements indicating: *"No assurance is provided on these financial statements."*
- Accountant wants to add to each page of the financial statements an option "*See Accountant's Disclaimer Report*" legend.
- There is no statement of cash flows and substantially all disclosures are omitted.

Conclusion:

- A disclaimer report is issued because the "*no assurance*" legend is omitted from each page of the financial statements.
- An option legend stating "*See Accountant's Disclaimer Report*" to each page of the financial statements.
- There is a legend on each page of the financial statements for the GAAP departure (no statement of cash flows)
- There is a legend on each page of the financial statements noting that substantially all disclosures are omitted.

Board of Directors and Management
XYZ Company

The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20X2 and 20X1, were not subjected to an audit, review, or compilation engagement by me (us) and, I (we) do not express an opinion, a conclusion, nor provide any assurance on them.

Signature of accounting firm or accountant
Accountant's city and state

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Short-term notes payable	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

See accountant's disclaimer report.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

See accountant's disclaimer report.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

XYZ Company
Schedules of Operating Expenses
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rent	$XX	$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	XX	XX
	$XX	$XX

See accountant's disclaimer report.

The financial statements do not include a statement of cash flows.

Substantially all disclosures required by accounting principles generally accepted in the United States are not included.

Example 7: Preparation of GAAP Financial Statements – No Statement of Cash Flows and Selected Disclosures of a Few Matters Included in the Financial Statements.

Facts:

- An accountant is engaged to prepare a GAAP balance sheet, income statement and schedule of operating expenses.
- The client does not want a statement of cash flows (GAAP departure).
- The financial statements include disclosures about a few matters and omit substantially all disclosures.

Conclusion: GAAP statements should be prepared with the following:

- Legend on each page stating there is "*no assurance*"
- Legend on each page of the financial statements for the GAAP departure (no statement of cash flows)
- Header on each page of the notes stating:
  "Selected Information- Substantially All Disclosures Required by GAAP Are Not Included."

XYZ Company
Balance Sheets
December 31, 20X2 and 20X1

	20X2	20X1
ASSETS		
Cash	$XX	$XX
Accounts receivable	XX	XX
Property and equipment, net	XX	XX
Other assets	XX	XX
	XX	XX
	$XX	$XX
LIABILITIES AND STOCKHOLDER'S EQUITY		
Liabilities:		
Accounts payable	$XX	$XX
Accrued expenses	XX	XX
Current portion of long-term debt	XX	XX
Long-term debt	XX	XX
	XX	XX
Stockholders' equity:		
Common stock	XX	XX
Retained earnings	XX	XX
	XX	XX
	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

XYZ Company
Statements of Income and Retained Earnings
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Net sales	$XX	$XX
Cost of goods sold	XX	XX
Gross profit	XX	XX
Operating expenses	XX	XX
Net operating income	XX	XX
Other income	XX	XX
Net income before income taxes	XX	XX
Income taxes	XX	XX
Net income	XX	XX
Retained earnings:		
Beginning of year	XX	XX
End of year	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

XYZ Company
Schedules of Operating Expenses
Years Ended December 31, 20X2 and 20X1

	20X2	20X1
Rent	$XX	$XX
Utilities	XX	XX
Insurance	XX	XX
Payroll and payroll related expenses	XX	XX
Office supplies	XX	XX
Professional fees	XX	XX
Repairs and maintenance	XX	XX
Travel and entertainment	XX	XX
Sundry other	$XX	$XX
	$XX	$XX

No assurance is provided on these financial statements.

The financial statements do not include a statement of cash flows.

XYZ Company
Notes to Financial Statements
Years Ended December 31, 20X2 and 20X1
Selected Information- Substantially All Disclosures Required
By GAAP Are Not Included

NOTE 1: LONG-TERM DEBT

Long-term debt consisted of the following at December 31, 20X2 and 20X1:

	20X2	20X1
Bank Note: Mortgage loan payable in monthly principal payments of $6,667 (annual of $80,000) plus interest at 3% per annum. The unpaid note balance is due on December 31, 20X8. The note is secured by a first mortgage on certain company real estate.	$420,000	$500,000
Shareholder: Unsecured term note requiring semiannual principal payments of $10,000 through June 30, 20X9, plus interest at 110% of the treasury bill rate (3.3% rate at December 31, 20X2).	180,000	200,000
	600,000	700,000
Less current portion	100,000	100,000
	$500,000	$600,000

A summary of the annual maturities of long-term debt for the five years subsequent to year end follows:

Year	Principal payments
20X3	$100,000
20X4	100,000
20X5	100,000
20X6	100,000
20X7	100,000

NOTE 2: LEASES

The Company has entered into various equipment leases with total monthly payments of $8,000 and various expiration dates through 20X8. A summary of the future minimum lease payments under these operating leases follows:

Year	Minimum lease payments
20X3	$96,000
20X4	96,000
20X5	96,000
20X6	96,000
20X7	96,000
Beyond 20X7	75,000
Total minimum lease payments	$555,000

Total rent expense under these leases was $94,000.

Observation: In Example 7, disclosure is made of a few matters. SSARS No. 21 states that when an accountant prepares financial statements that include disclosures about only a few matters in the notes, such disclosures should be labeled: *"Selected Information- Substantially All Disclosures Required by GAAP Are Not Included."* The label must be included on each page of the notes only, and not on the financial statement pages. Moreover, because not all disclosures are included, there is a GAAP departure because substantially all disclosures are omitted. SSARS No. 21 states that when substantially all disclosures are omitted, a disclosure must be included either on the face of the financial statements or on a note. By including the language "Selected Information- Substantially All Disclosures Required By GAAP Are Not Included" on each page of the selected notes, there is no requirement to reiterate the fact that substantially all disclosures are omitted either on the face of the financial statements or in a separate note.

L. Preparation of Personal Financial Statements

GAAP for personal financial statements is found in ASC 274, *Personal Financial Statements* (formerly SOP 82-1). ASC 274 *establishes* accounting standards for GAAP-basis personal financial statements.

ASC 274 requires the following:

a. Personal financial statement assets must be stated at their <u>estimated current values</u>, and liabilities at their <u>estimated current amounts</u>. The <u>costs of disposal of assets</u>, if material, should be deducted in computing current values.

b. A statement of financial condition is required while a statement of changes in net worth is optional.

c. A hypothetical estimated income tax liability must be calculated and presented in the liability section of the statement of net worth as follows:

Estimated current value of net assets	$XX
Tax basis of net assets	<u>XX</u>
Hypothetical gain	XX
Tax rate (s)	<u>XX</u>%
Estimated income tax liability on difference between value and tax basis of net assets	*$XX

* Presented as liability on the statement of financial condition

d. ASC 274 requires disclosures.

In most cases, personal financial statements are prepared using a bank's prescribed form, instead of the borrower creating his or her own personal financial statement. In completing a bank's prescribed form, there are logistical issues as to how SSARS No. 21 applies to the completion of that bank's prescribed form.

A prescribed form is a standard preprinted form designed or adopted by the body to which it is to be submitted.

Examples of prescribed forms include:

- A personal financial statement on a bank's preprinted form
- Industry trade association form
- Governmental or regulatory body form

Is an accountant permitted to perform a preparation of financial statements engagement under AR-C 70 on a prescribed form?

Prior to the effective date of SSARS No. 21, the guidance for the rules for reporting on a prescribed form was found in SSARS No. 3, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*. SSARS No. 3 permitted an accountant to issue a compilation report on a prescribed form financial statement, such as a bank's preprinted personal financial statement. SSARS No. 3 offered a specific compilation report format for reporting on a prescribed form. SSARS No. 21 superseded SSARS No. 3. Now, the formal guidance on reporting on a prescribed form is found in the AICPA Guide.

The question is whether an accountant is permitted to perform a preparation of financial statements engagement on a bank's prescribed form personal financial statement.

The answer is that nothing within SSARS No. 21 precludes an accountant from performing a preparation of financial statements engagement on a bank's prescribed form personal financial statement or, for that matter, a GAAP personal financial statement.

Paragraph 3.44 of the AICPA Guide offers guidance on performing a preparation engagement on a prescribed form.

1. In a prescribed form, there is a *presumption* that the information required by the prescribed form is *sufficient* to meet the needs of the body (such as a bank) that designated or adopted the form.

2. Because the form is deemed to be sufficient for the body's (bank's) needs, there is no need to advise the body (bank) of any departures from the applicable framework (such as GAAP) that are required by the form, including inadequacy of disclosures.

3. If there is a departure from the applicable framework other than departures that are called for by the prescribed form, that departure should be treated as a departure from the framework.

    Note: Under the AR-C 70 preparation rules, if there is a departure from a framework, that departure should be disclosed either on the face of each page of the financial statements or in a related note.

Example: A bank personal financial statement (a prescribed form) has a statement of financial condition that uses GAAP as its framework. GAAP requires assets to be presented at estimated current values and liabilities at estimated current amounts. GAAP also requires that an estimated tax liability be recorded.

However, the form does not call for (require) that the statement of financial condition present an estimated tax liability which is required by GAAP.

Conclusion: There is a presumption that the information on the bank's prescribed form is sufficient to meet the needs of the bank. Thus, even though the form has a departure from GAAP (missing tax liability), that difference is not treated as a GAAP departure because the form calls for departure from the GAAP framework. The disclosures on the prescribed form are deemed to be sufficient for that bank's prescribed form framework.

Change the facts: Assume that in addition to the missing tax liability, the personal financial statement is prepared by recording the borrower's home at cost, instead of estimated current value required by the form.

Conclusion: The fact that the home is recorded at cost is a departure from the prescribed form which calls for recording the home at estimated current value. Thus, recording the home at cost is a departure from the framework. That departure should be handled by disclosing the departure either on the face of each page of the prescribed form or in a related note to the form.

4. In a preparation engagement of a prescribed form, the following rules should be followed consistent with AR-C 70:

   a. Each page of the prescribed form personal financial statement must state, *"no assurance is provided on these financial statements"* or similar language.

      Note: If the client does not wish to add the "*no assurance*" legend, the accountant must attach a disclaimer report.

   b. The accountant must follow the preconditions found in AR-C 60 general conditions, as well as the overall performance requirements found in AR-C 70.

   Example 1: Mary Jones, CPA performs a preparation of financial statements engagement on John Smith's prescribed form personal financial statement for the year ended December 31, 2016. A compilation, review or audit engagement is not performed.

   The only GAAP departure in the prescribed form personal financial statement is that the personal financial statement does not include an "estimated tax liability" that is required under GAAP for personal financial statements. Substantially all GAAP disclosures are omitted.
   Conclusion: Mary should follow the rules for a preparation of financial statements engagement under AR-C 70 as follows:

   a. Each page of the prescribed form personal financial statement must state:

      "No assurance is provided on these financial statements."

b. If the client does not wish to add the "*no assurance*" legend, Mary must attach a disclaimer report.

c. There is no requirement to disclose the GAAP departure (missing estimated tax liability) because it is presumed that the information on the prescribed form is sufficient for the bank's needs.

d. There is no requirement to include on each page a legend stating that substantially all disclosures required by GAAP are not included. It is presumed that all disclosures on the form are sufficient for the needs of the bank.

On the following pages, the author provides sample personal financial statements on a prescribed bank form based on the Example 1 information. The prescribed form is prepared under the AR-C 70 rules.

NEVER LOAN BANK
WE SAY NEVER WITH A SMILE

PERSONAL FINANCIAL STATEMENT **CONFIDENTIAL**

As of: 12-31-16	**IMPORTANT: INSTRUCTIONS TO APPLICANT**
Name: John Smith	
Address: 112 Jones Blvd	Read directions before completing Financial Statement.
City/Town: Boston State: MA	Please check appropriate box
Employer/position: Big Dog Manufacturing	**X** Individual credit—If relying on your own income and assets and not the income and assets of a spouse or another person as a basis for Extension or repayment or credit, complete the Financial Statement below.
Date of birth: 04-04-52	
Social security number: 023-33-4435	
Spouse name:	☐ Joint Credit — If applying for joint credit or for individual credit relying on income or assets of a spouse or another person for extension and repayment of credit requested,
Address:	
City/Town: State:	
Employer/position:	☐ Individual relying upon income or assets of spouse or other person. — complete the Financial Statement below. Include information about income, assets, and liabilities of the spouse or other person. Both Applicant and Spouse or Co-Applicant sign this statement.
Date of birth:	
Social security number:	
Please do not leave any questions unanswered. Use "no" or "none" where necessary.	

FINANCIAL CONDITION AS OF December 31, 2016

Assets	*In Even Dollars*	*Liabilities and Net Worth*	*In Even Dollars*
Cash on hand and in Banks—See Schedule A	$ 200,000	Notes Payable: This Bank—See Schedule A	$1,000,000
Government Securities—See Schedule B		Notes Payable: Other Institutions—See Schedule A	
Listed Securities—See Schedule B	3,800,000		
Unlisted Securities—See Schedule B		Notes Payable—Relatives	
Other Equity Interests—See Schedule B		Notes Payable—Others	
Accounts and Notes Receivable		Accounts and Bills Due	25,000
Real Estate Owned—See Schedule C	4,000,000	Unpaid Taxes	
Mortgages and Land Contracts Receivable—See Schedule D		Real Estate Mortgages Payable—See Schedule C or D	1,300,000
Cash Value Life Insurance—See Schedule E		Land Contracts Payable—See Schedule C or D	
Other Assets: Itemize	150,000	Life Insurance Loans—See Schedule E	
Furniture and fixtures	50,000	Other Liabilities: Itemize	
		Miscellaneous payables	75,000
		TOTAL LIABILITIES	$2,400,000
		NET WORTH	$5,800,000
TOTAL ASSETS	$8,200,000	**TOTAL LIABILITIES AND NET WORTH**	$8,200,000

No assurance is provided on these financial statements.

Sources of Income	*In Even Dollars*	*General Information*	
Salary	$	Employer Smith, Smith and Alfonzo, Attorneys at Law	
Bonus and Commissions		Position or Profession Partner	No. Years 25
Dividends	200,000	Employer's Address 10 State St., Boston, MA	
Real Estate Income	170,000	Phone No. 617-628-4400	
*Other Income: Itemize		Partner, officer or owner in any other venture? X No ☐ Yes	
Partnership income K-1	250,000	If so, explain:	
TOTAL	$620,000		
*Alimony, child support or separate maintenance payments need not Be disclosed unless relied upon as a basis for extension of credit. If disclosed, payments received under ☐ court order ☐ written agreement ☐ oral understanding.		Are any assets pledged? ☐ No X Yes Detail in Schedule A and C	
		Income taxes settled through (Date) 2011	

Contingent Liabilities	*In Even Dollars*	*General Information (continued)*
As endorser, co-maker or guarantor	$	Are you a defendant in any suits or legal action? X No ☐ Yes
On leases		If so, explain:
Legal claims		Have you ever taken bankruptcy? X No x Yes
Provision for federal income taxes	100,000	If so, explain:
Other special debt, e.g., recourse or repurchase liability		Do you have a will? ☐ No X Yes
		Do you have a trust? ☐ No X Yes
TOTAL	$100,000	Number of dependents 2 Ages 16 and 19

Schedule A: Banks, Brokers, Savings & Loan Association, Finance Companies or Credit Unions. List here the names of all the institutions at which you maintain a deposit account and/or where you have obtained loans.

Name of Institution	*Name on Account*	*Balance on Deposit*	*High Credit*	*Amount Owing*	*Monthly Payment*	*Secured by What Assets*
Bank of America	John Smith	$150,000	$0	$0	$0	$0
TD Bank	John Smith	50,000	0	0	0	0
No Loan Bank	John Smith			1,000,000	4,500	0
	TOTAL	$200,000	**TOTAL**	$1,000,000	$4,500	$0

Schedule B: U.S. Governments, Stocks (Listed & Unlisted), Bonds (Gov't & Comm.), and Partnership Interests (General & Ltd.)

Number of Shares, Face Value (Bonds), or % of Ownership	*Indicate: 1. Agency or name of company issuing security or name of partnership 2. Type of investment or equity classification 3. Number of shares, bonds or % of ownership held 4. Basis of valuation**	*In Name of*	**Market Value*	*Pledged Yes (▤)*	*Pledged No (▤)*
10,300	IBM	John Smith	400,000		X
18,000	Microsoft	John Smith	1,800,000		X
20,000	Ford	John Smith	1,000,000		X
10,000	General Electric	John Smith	600,000		X
		TOTAL	3,800,000		

*If unlisted security or partnership interest, provide current financial statements to support basis for valuation.

No assurance is provided on these financial statements.

Schedule C: Real Estate Owned (and related debt, if applicable)

Description of Property or Address	*Title in Name Of*	*Date Acq.*	*Cost + Improvements*	*Present Mkt. Value*	*Mortgage or Land Contract Payable*		
					Bal. Owing	*Mo. Payt.*	*Holder*
130 Reginald St, Boston, MA	John Smith	2005	$1,500,000	$3,000,000	$1,000,000	$5,000	BOA
Residence- 112 Jones Blvd, Boston, MA	John and Mary Smith	1990	130,000	1,000,000	300,000	1,500	BOA
		TOTAL		$4,000,000	$1,300,000	$6,500	

Schedule D: Real Estate: Mortgages & Land Contracts Receivable (and related debt, if applicable)

Description of Property or Address	*Title in Name Of*	*Date Acq.*	*Balance Receivable*	*Monthly Payment*	*Mortgage or Land Contract Payable*		
					Bal. Owing	*Mo. Payt.*	*Holder*
		TOTAL					

Schedule E: Life Insurance Carried

Name of Company	*Face Amount*	*Cash Surrender Value*	*Loans*	*Beneficiary*
TOTAL				

I/we have carefully read and submitted the foregoing information provided on all three pages of this statement to the Bank named above. The information is presented as a true and accurate statement of my/our financial condition on the date indicated. This statement is provided for the purpose of obtaining and maintaining credit with said Bank. I/we agree that if any material change(s) occur(s) in my/our financial condition that I/we will immediately notify said Bank of said change(s) and unless said Bank is so notified it may continue to rely upon this financial statement and the representations made herein as a true and accurate statement of my/our financial condition.

I/we authorize the Bank to make whatever credit inquiries it deems necessary in connection with this financial statement. I/we authorize and instruct any person or consumer reporting agency to furnish to the Bank any information that it may have or obtain in response to such credit inquiries.

I/we also hereby certify that no payment requirements listed herein are delinquent or in default except as follows; if "NONE" so state.

I/we fully understand that it is a federal crime punishable by fine or imprisonment or both to knowingly make any false statements concerning any of the above facts.

Applicant's Signature ________________________________ Date Signed ______________

Spouse's or Co-Applicant's Signature ________________________________ Date Signed ______________

No assurance is provided on these financial statements.

Example 2: Same facts as Example 1 except that the client does not wish to place a "no assurance" legend on each page of the personal financial statements

Conclusion: In accordance with SSARS No. 21, Mary must attach a disclaimer report.

> John Smith
> 111 Jones Road
> Nowhere, Massachusetts
>
> The accompanying statement of financial condition of John Smith as of December 31, 2016 included in the accompanying prescribed form, was not subjected to an audit, review, or compilation engagement by me and, I do not express an opinion, a conclusion, nor provide any assurance on it.
>
> Mary Jones, CPA
> Boston, Massachusetts

NEVER LOAN BANK
WE SAY NEVER WITH A SMILE

PERSONAL FINANCIAL STATEMENT — CONFIDENTIAL

As of: 12-31-16	**IMPORTANT: INSTRUCTIONS TO APPLICANT**
Name: John Smith	
Address: 112 Jones Blvd	Read directions before completing Financial Statement.
City/Town: Boston State: MA	Please check appropriate box
Employer/position: Big Dog Manufacturing	X Individual credit—If relying on your own income and assets and not the income and assets of a spouse or another person as a basis for Extension or repayment or credit, complete the Financial Statement below
Date of birth: 04-04-52	
Social security number: 023-33-4435	
Spouse name:	☐ Joint Credit — If applying for joint credit or for individual credit relying on income or assets of a spouse or another person for extension and repayment of credit requested,
Address:	
City/Town: State:	
Employer/position:	☐ Individual relying upon income or Assets of spouse or other person. — Complete the Financial Statement below. Include Information about income, assets and liabilities of the spouse or other person. Both Applicant and Spouse or Co-Applicant sign this statement.
Date of birth:	
Social security number:	
Please do not leave any questions unanswered. Use "no" or "none" where necessary.	

FINANCIAL CONDITION AS OF December 31, 2016

Assets	*In Even Dollars*	*Liabilities and Net Worth*	*In Even Dollars*
Cash on hand and in Banks—See Schedule A	$ 200,000	Notes Payable: This Bank—See Schedule A	$1,000,000
Government Securities—See Schedule B		Notes Payable: Other Institutions—See Schedule A	
Listed Securities—See Schedule B	3,800,000		
Unlisted Securities—See Schedule B		Notes Payable—Relatives	
Other Equity Interests—See Schedule B		Notes Payable—Others	
Accounts and Notes Receivable		Accounts and Bills Due	25,000
Real Estate Owned—See Schedule C	4,000,000	Unpaid Taxes	
Mortgages and Land Contracts Receivable—See Schedule D		Real Estate Mortgages Payable—See Schedule C or D	1,300,000
Cash Value Life Insurance—See Schedule E		Land Contracts Payable—See Schedule C or D	
Other Assets: Itemize	150,000	Life Insurance Loans—See Schedule E	
Furniture and fixtures	50,000	Other Liabilities: Itemize	
		Miscellaneous payables	75,000
		TOTAL LIABILITIES	$2,400,000
		NET WORTH	$5,800,000
TOTAL ASSETS	$8,200,000	**TOTAL LIABILITIES AND NET WORTH**	$8,200,000

Sources of Income	*In Even Dollars*	*General Information*	
Salary	$	Employer Smith, Smith and Alfonzo, Attorneys at Law	
Bonus and Commissions		Position or Profession Partner	No. Years 25
Dividends	200,000	Employer's Address 10 State St., Boston, MA	
Real Estate Income	170,000	Phone No. 617-628-4400	
*Other Income: Itemize		Partner, officer or owner in any other venture? X No ☐ Yes	
Partnership income K-1	250,000	If so, explain:	
TOTAL	$620,000		
*Alimony, child support or separate maintenance payments need not Be disclosed unless relied upon as a basis for extension of credit. If disclosed, payments received under ☐ court order ☐ written agreement ☐ oral understanding.		Are any assets pledged? ☐ No X Yes Detail in Schedule A and C	
		Income taxes settled through (Date) 2011	

Contingent Liabilities	*In Even Dollars*	*General Information (continued)*
As endorser, co-maker or guarantor	$	Are you a defendant in any suits or legal action? X No ☐ Yes If so, explain:
On leases		
Legal claims		Have you ever taken bankruptcy? X No x Yes
Provision for federal income taxes	100,000	If so, explain:
Other special debt, e.g., recourse or repurchase liability		Do you have a will? ☐ No X Yes
		Do you have a trust? ☐ No X Yes
TOTAL	$100,000	Number of dependents 2 Ages 16 and 19

Schedule A: Banks, Brokers, Savings & Loan Association, Finance Companies or Credit Unions. List here the names of all the institutions at which you maintain a deposit account and/or where you have obtained loans.

Name of Institution	*Name on Account*	*Balance on Deposit*	*High Credit*	*Amount Owing*	*Monthly Payment*	*Secured by What Assets*
Bank of America	John Smith	$150,000	$0	$0	$0	$0
TD Bank	John Smith	50,000	0	0	0	0
No Loan Bank	John Smith			1,000,000	4,500	0
	TOTAL	$200,000	**TOTAL**	$1,000,000	$4,500	$0

Schedule B: U.S. Governments, Stocks (Listed & Unlisted), Bonds (Gov't & Comm.), and Partnership Interests (General & Ltd.)

Number of	*Indicate:*			*Pledged*	
Shares, Face Value (Bonds), or % of Ownership	*1. Agency or name of company issuing security or name of partnership* *2. Type of investment or equity classification* *3. Number of shares, bonds or % of ownership held* *4. Basis of valuation**	*In Name of*	**Market Value*	*Yes (▤)*	*No (▤)*
10,300	IBM	John Smith	400,000		X
18,000	Microsoft	John Smith	1,800,000		X
20,000	Ford	John Smith	1,000,000		X
10,000	General Electric	John Smith	600,000		X
		TOTAL	3,800,000		

*If unlisted security or partnership interest, provide current financial statements to support basis for valuation.

Schedule C: Real Estate Owned (and related debt, if applicable)

Description of Property or Address	*Title in Name Of*	*Date Acq.*	*Cost + Improvements*	*Present Mkt. Value*	*Mortgage or Land Contract Payable*		
					Bal. Owing	*Mo. Payt.*	*Holder*
130 Reginald St, Boston, MA	John Smith	2005	$1,500,000	$3,000,000	$1,000,000	$5,000	BOA
Residence- 112 Jones Blvd, Boston, MA	John and Mary Smith	1990	130,000	1,000,000	300,000	1,500	BOA
		TOTAL		$4,000,000	$1,300,000	$6,500	

Schedule D: Real Estate: Mortgages & Land Contracts Receivable (and related debt, if applicable)

Description of Property or Address	*Title in Name Of*	*Date Acq.*	*Balance Receivable*	*Monthly Payment*	*Mortgage or Land Contract Payable*		
					Bal. Owing	*Mo. Payt.*	*Holder*
		TOTAL					

Schedule E: Life Insurance Carried

Name of Company	*Face Amount*	*Cash Surrender Value*	*Loans*	*Beneficiary*
TOTAL				

I/we have carefully read and submitted the foregoing information provided on all three pages of this statement to the Bank named above. The information is presented as a true and accurate statement of my/our financial condition on the date indicated. This statement is provided for the purpose of obtaining and maintaining credit with said Bank. I/we agree that if any material change(s) occur(s) in my/our financial condition that I/we will immediately notify said Bank of said change(s) and unless said Bank is so notified it may continue to rely upon this financial statement and the representations made herein as a true and accurate statement of my/our financial condition.

I/we authorize the Bank to make whatever credit inquiries it deems necessary in connection with this financial statement. I/we authorize and instruct any person or consumer reporting agency to furnish to the Bank any information that it may have or obtain in response to such credit inquiries.

I/we also hereby certify that no payment requirements listed herein are delinquent or in default except as follows; if “NONE” so state.

I/we fully understand that it is a federal crime punishable by fine or imprisonment or both to knowingly make any false statements concerning any of the above facts.

Applicant's Signature ________________________________ Date Signed ______________

Spouse's or Co-Applicant's Signature ________________________________ Date Signed ______________

Observation: Notice that Example 2 does not include a "no assurance" legend on each page of the financial statements. AR-C 70 of SSARS No. 21 states that if a "no assurance" legend is not included on each page of the prescribed form, the accountant must include a disclaimer report. The disclaimer report addresses the only statement, which is the statement of financial condition which is part of the prescribed form.

Review Questions and Suggested Solutions

REVIEW QUESTIONS

Under the NASBA-AICPA self-study standards, self-study sponsors are required to present review questions intermittently throughout each self-study course. Additionally, feedback must be given to the course participant in the form of answers to the review questions and the reason why answers are correct or incorrect. To obtain the maximum benefit from this course, we recommend that you complete each of the following questions, and then compare your answers with the solutions that immediately follow.

1. To which of the following engagements do the standards found in AR-C 70 of SSARS No. 21 apply:
   a. Preparation of financial statements by an accountant in industry and there is no other engagement performed on those financial statements
   b. Preparation of financial statements by an accountant in public practice and the accountant is also engaged to perform an audit on those same financial statements
   c. Preparation of financial statements by an accountant in public practice and the accountant is not engaged to perform any other engagement on those same financial statements
   d. Preparation of financial statements by an accountant in industry and the accountant is also performing a review engagement on those same financial statements

2. Ivan the accountant is preparing financial statements for a client. Which of the following is an example of a situation in which Ivan's preparation of financial statements engagement would be subject to the rules found in AR-C 70:
   a. Preparation of financial statements solely for Ivan to submit to the IRS with the tax return
   b. Preparation of financial statements that will be part of a business valuation service
   c. Preparation of financial statements by Ivan prior to another CPA firm performing a review engagement on the same financial statements
   d. Preparation of financial statements that will be included as part of a personal financial plan that Ivan will prepare for his client

3. Carla Carlson CPA is preparing financial statements and also performing a review engagement on the same financial statements. Which standards should Carla follow:
   a. AR-C 70 for the preparation engagement, and AR-C 90 for the review engagement
   b. AR-C 70 for the preparation engagement and AR-C 60 for the review engagement
   c. AR-C 70 for both engagements
   d. AR-C 90 for both engagements

4. Big Jimmy Johnston, CPA is hired to perform a preparation of financial statements engagement for 20X1. Jimmy completes the engagement and six months later is asked to perform a compilation engagement for the same 20X1 period. Which of the following is correct based on the author's opinion:
   a. The author suggests that the preparation engagement and compilation engagement should be treated as two separate engagements
   b. The author suggests that both engagements should be treated as a preparation engagement under AR-C 70
   c. The author suggests that both engagements should be treated as a compilation engagement under AR-C 80

d. The author suggests that the two engagements are not covered by the SSARSs

5. Which of the following is not a basis of accounting included under the special purpose framework:
   a. Cash basis
   b. Tax basis
   c. Contractual basis
   d. Accrual basis

6. One of the ways in which the definition of tax basis has changed is that the new definition_________:
   a. Removes the language “expects to use” from the definition
   b. Removes the term “substantial support” from the definition
   c. Adds the term “federal” to the definition
   d. Is the same as the previous SAS No. 62 definition

7. Which of the following is correct with respect the rules for a preparation of financial statements engagement under AR-C 70:
   a. The accountant must be independent
   b. A special report must be issued in all cases
   c. An engagement letter must be signed by management but not the accountant
   d. The financial statements may be issued to the client or third party

8. An accountant performs a preparation of financial statements engagement under AR-C 70. The accountant obtains information from management to prepare the financial statements. Which of the following properly identifies the accountant's responsibility with respect to the information obtained from management:
   a. The accountant is required to verify the accuracy of the information
   b. The accountant is required to verify the completeness of the information
   c. The accountant is required to verify the completeness, but not the accuracy of the information
   d. The accountant is not required to verify the accuracy or completeness of the information

9. In a preparation of financial statements engagement, which of the following is an appropriate legend to place on each page of the financial statements:
   a. "See Accountant's Preparation Report"
   b. "No assurance is provided on these financial statements"
   c. "See Notes to Financial Statement"
   d. "See Independent Accountant's Report"

10. Sophia Rapallo is an accountant who is hired to prepare financial statements for her client. The client wants her to prepare her financial statements on the tax basis, which is a special purpose framework. What must the accountant do with respect to the special purpose framework:
    a. She should include a description of the framework in the accountant's report
    b. She should include a description of the framework in the notes to financial statements but not on the face of the financial statements
    c. She should include the description of the framework on the face of the financial statements or in the notes to financial statements
    d. She should do nothing as no modification is required

11. Elaine Liberman is performing a preparation of financial statements engagement under AR-C 70. Elaine discovers a significant error that makes the financial statements inaccurate. How should Elaine handle this profound discovery of a significant error:
    a. Elaine should dig a deep hole in the sand, stick her head in it and act like an ostrich. There is no requirement to verify or correct errors in a preparation engagement
    b. Elaine should bring the error to the attention of the third-party users
    c. Elaine should bring the error to the attention of management and request from management any additional information and/or corrected information
    d. Elaine must modify her preparation report to identify the error, if it is material

12. Joseph Coatman is performing a preparation of financial statements engagement under AR-C 70. The financial statements omit substantially all disclosures. Which of the following is the correct way in which Joseph should deal with the omission of disclosures:
    a. The disclosure of the omission should be made on the face of the financial statements or in a note to the financial statement
    b. The disclosure of the omission must be made in a note to the financial statements
    c. Nothing must be done by Joseph
    d. Disclosure must be made in the preparation report

13. An accountant is performing a preparation of financial statements engagement under AR-C 70 on a client's financial statements. There is no statement of cash flows and substantially all disclosures are omitted. Which of the following identifies the legends that should be presented on each page of the financial statements:
    a. There should be three legends
    b. There should be two legends
    c. There should be one legend
    d. No legends are required

14. An accountant is preparing tax-basis financial statements under AR-C 70. Substantially all disclosures are omitted. Which of the following is correct:
    a. A disclosure is required stating that substantially all disclosures required are omitted
    b. A disclosure is required stating that substantially all disclosures ordinarily included are omitted
    c. No disclosure is required
    d. A disclosure is required stating that substantially all disclosures generally considered important are omitted

15. Which of the following is an item that should be documented in a preparation of financial statements engagement under AR-C 70:
    a. A copy of the financial statements
    b. A copy of the accountant's preparation report
    c. Preparation checklist
    d. A management representation letter

SUGGESTED SOLUTIONS

1. To which of the following engagements do the standards found in AR-C 70 of SSARS No. 21 apply assuming an accountant is engaged to perform the engagement:
   a. Incorrect. A preparation of financial statements engagement under AR-C 70 requires the accountant to be in public accounting, not industry, making the answer incorrect. If the accountant were in public accounting, the fact that there is no other engagement performed on those financial statements would make the engagement subject to the AR-C 70 standards.
   b. Incorrect. In order for the preparation of financial statements engagement to be covered by AR-C 70, not only must the accountant be in public practice, but there cannot be any compilation, review or audit engagement performed on those same financial statements. In this case, an audit is performed. Thus, the answer is incorrect.
   c. Correct. A preparation of financial statements engagement is covered by AR-C 70 if an accountant is in public practice and the accountant is not engaged to perform any other engagement on those same financial statements. Both of those requirements are met making the answer correct.
   d. Incorrect. The answer is incorrect for two reasons. First, a preparation of financial statements engagement requires the accountant to be in public practice, which is not the case in this example. Second, there can be no compilation, review or audit engagement performed on the same financial statements. In this example, a review engagement is being performed, thereby disqualifying the engagement for coverage under AR-C 70.

2. Ivan the accountant is preparing financial statements for a client. Which of the following is an example of a situation in which Ivan's preparation of financial statements engagement would be subject to the rules found in AR-C 70:
   a. Incorrect. If Ivan prepares financial statements for the sole purpose of submitting them to the IRS with the tax return, AR-C 70 states that such statements are not covered under AR-C 70.
   b. Incorrect. AR-C 70 states that the preparation of financial statements that will be part of a business valuation service are not covered by AR-C 70.
   c. Correct. AR-C 70 provides that if financial statements are prepared by an accountant prior to another CPA firm performing a compilation, review or audit engagement on the same financial statements, those financial statements are covered by the AR-C 70 standards. Thus, the answer is correct.
   d. Incorrect. AR-C 70 states that the AR-C 70 rules do not apply if an accountant prepares financial statements that will be included as part of a personal financial plan. Thus, the answer is incorrect.

3. Carla Carlson CPA is preparing financial statements and also performing a review engagement on the same financial statements. Which standards should Carla follow:
   a. Incorrect. When a preparation engagement is performed as part of a review engagement, the accountant does not bifurcate the rules into two sections. Instead, the review standards are followed under AR-C 90 only. AR-C 70's preparation of financial statement rules do not apply.
   b. Incorrect. AR-C 70 does not apply because a review is performed on the same financial statements. Moreover, AR-C 60 represents the general principles and not the rules for a review engagement.
   c. Incorrect. The AR-C 70 standards apply only when a preparation engagement is performed and there is no compilation, review or audit engagement on the same financial statements. This is not the case in this example.

- **d. Correct. Because a preparation and also a review engagement are performed on the same financial statements, AR-C 70 states that the accountant should follow only the review standards found in AR-C 90.**

4. Big Jimmy Johnston, CPA is hired to perform a preparation of financial statements for 20X1. Jimmy completes the engagement and six months later is asked to perform a compilation engagement for the same 20X1 period. Which of the following is correct based on the author's opinion:
   - **a. Correct. Because the two engagements are not performed at the same or similar time, the author suggests that the preparation engagement and compilation engagement should be treated as two separate engagements; one under AR-C 70 and the other under AR-C 80's compilation rules.**
   - b. Incorrect. Under no circumstances does the author suggest that both engagements should be treated as a preparation engagement under AR-C 70. There is nothing within the SSARSs that permits a preparation engagement and review engagement performed for the same financial statements to follow the standards under AR-C 70.
   - c. Incorrect. If the engagements had been done either simultaneously or at a similar time, the standards found in AR-C 80 with respect to compilation engagements would be followed. In this example, there is a six-month lag time between performing the preparation engagement and the compilation engagement. Thus, performing both engagements under only the AR-C 80 compilation rules is not appropriate.
   - d. Incorrect. Regardless of which set of standards are followed, both engagements are covered by the SSARSs making the answer incorrect.

5. Which of the following is <u>not</u> a basis of accounting included under the special purpose framework:
   - a. Incorrect. The cash basis is an example of a basis under the special purpose framework as defined by SSARS No. 21.
   - b. Incorrect. The tax basis is an example of a basis under the special purpose framework. A special purpose framework is a non-GAAP framework.
   - c. Incorrect. The contractual basis is an example of a basis under the special purpose framework.
   - **d. Correct. The accrual basis of accounting, by itself, is not a basis included under the definition of a special purpose framework, making the answer correct.**

6. One of the ways in which the definition of tax basis has changed is that the new definition_________:
   - **a. Correct. The previous definition included the term "expects to use" which was removed from the definition found in SSARS No. 21.**
   - b. Incorrect. The term "substantial support" was previously found in one of the categories of OCBOA financial statements but had nothing to do with the definition of tax-basis financial statements.
   - c. Incorrect. The term "federal" was not added to the definition.
   - d. Incorrect. There were changes in the definition making the answer incorrect.

7. Which of the following is correct with respect the rules for a preparation of financial statements engagement under AR-C 70:
   - a. Incorrect. The accountant is not required to be independent to perform a preparation engagement under AR-C 70.
   - b. Incorrect. In general, no report is required in a preparation of financial statements engagement.
   - c. Incorrect. The engagement letter must be signed by both management and the accountant making the answer incorrect.

d. Correct. AR-C 70 permits the prepared financial statements to be issued to the client or a third party without any restrictions.

8. An accountant performs a preparation of financial statements engagement under AR-C 70. The accountant obtains information from management to prepare the financial statements. Which of the following properly identifies the accountant's responsibility with respect to the information obtained from management:
   a. Incorrect. AR-C 70 states that the accountant is not required to verify the accuracy of the information or, for that matter, gather evidence to express an opinion.
   b. Incorrect. Per AR-C 70, the accountant is not required to verify the completeness of the information.
   c. Incorrect. AR-C 70 is quite clear that the accountant is not required to verify the completeness or the accuracy of the information.
   d. Correct. AR-C 70 states that the accountant is not required to verify the accuracy or completeness of the information. Moreover, the accountant is not required to gather evidence to express an opinion or a conclusion on the statements.

9. In a preparation of financial statements engagement, which of the following is an appropriate legend to place on each page of the financial statements:
   a. Incorrect. The legend "*See Accountant's Preparation Report"* is not appropriate primarily because there is no report.
   b. Correct. SSARS No. 21, AR-C 70 states that a legend should be included on each page of prepared financial statements similar to "*No assurance is provided on these financial statements*" or "*These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them*."
   c. Incorrect. Although there is nothing to preclude an accountant from including a legend, "See Notes to Financial Statements," AR-C 70 does not mention that legend. Further, in many cases in a preparation engagement, management may elect to omit substantially all disclosures so that there are no notes to reference.
   d. Incorrect. AR-C 70 does not mention a legend such as "See Independent Accountant's Report." In particular, an accountant might not be independent in a preparation of financial statements engagement.

10. Sophia Rapallo is an accountant who is hired to prepare financial statements for her client. The client wants her to prepare her financial statements using the tax basis, which is a special purpose framework. What must the accountant do with respect to the special purpose framework:
   a. Incorrect. There is no report in a preparation of financial statements engagement in which to include a description.
   b. Incorrect. Sophia has a choice of including a description either in the notes to financial statements or on the face of the financial statements making the answer incorrect.
   c. Correct. AR-C 70 provides that a description must be provided either on the face of the financial statements or the notes to the financial statements making the answer correct.
   d. Incorrect. A modification is required which is to provide a description of the tax basis special purpose framework. Thus, the answer is incorrect.

11. Elaine Liberman is performing a preparation of financial statements engagement under AR-C 70. Elaine discovers a significant error that makes the financial statements inaccurate. How should Elaine handle this profound discovery of a significant error:

a. Incorrect. AR-C 70 does not permit Elaine to stick her head in the sand. Instead, she must bring the matter to the attention of management.
b. Incorrect. There is no requirement to bring the error or any other notification to the attention of the users. The responsibility is to bring the error to the attention of management.
c. Correct. AR-C 70 is quite clear that if during a preparation engagement, the accountant becomes aware of incomplete, inaccurate, or otherwise unsatisfactory information, the accountant is required to bring that fact to the attention of management and request additional information or corrected information. Thus, the answer is correct.
d. Incorrect. There is no report so that there is no mechanism to identify the error in a report.

12. Joseph Coatman is performing a preparation of financial statements engagement under AR-C 70. The financial statements omit substantially all disclosures. Which of the following is the correct way in which Joseph should deal with the omission of disclosures:
a. Correct. AR-C 70 requires that the disclosure of the omission be made either on the face of the financial statements or in a note, making the answer correct.
b. Incorrect. Joseph has the choice of presenting the disclosure of the omission either in a note to the financial statements or on the face of the financial statements.
c. Incorrect. AR-C 70 requires that a disclosure of the omission be made, making the answer incorrect.
d. Incorrect. There is no preparation report making the answer incorrect. If there is a disclaimer report, including the disclosure of the omission in that disclaimer report is not appropriate nor authorized by AR-C 70.

13. An accountant is performing a preparation of financial statements engagement under AR-C 70 on a client's financial statements. There is no statement of cash flows and substantially all disclosures are omitted. The accountant has no disclaimer report. Which of the following identifies the legends that should be presented on each page of the financial statements:
a. Correct. There should be three legends as follows: one for "no assurance," one for the omission of a statement of cash flows, and one for substantially all disclosures not being included.
b. Incorrect. There is automatically one legend regarding the "no assurance on the financial statements." Then, there must be one for the GAAP departure (no statement of cash flows) and one for the omission of disclosures. AR-C 70 requires legends/disclosures when there is a GAAP departure and substantially all disclosures are omitted. Thus, the total cannot be two legends.
c. Incorrect. The answer cannot be one legend if following the requirements of AR-C 70. There is one "no assurance" legend for all prepared financial statements. Because there is a GAAP departure and substantially all disclosures are omitted, there are two more disclosures/legends. Thus, one legend is incorrect.
d. Incorrect. There are three legends and certainly more than zero legends, making the answer incorrect. At a minimum, there is a "no assurance" legend. The fact that the accountant does not have a disclaimer report means that the "no assurance" legend is included. That "no assurance" legend, by itself, is at least one legend making the answer incorrect.

14. An accountant is preparing tax-basis financial statements under AR-C 70. Substantially all disclosures are omitted. Which of the following is correct:
a. Incorrect. The term "required" should not be included in the disclosure because there are no formal disclosures identified for tax-basis financial statements.
b. Correct. The term "ordinarily included" is appropriate because the tax basis does not have a codified list of required disclosures.

c. Incorrect. AR-C 70 requires that a disclosure/legend be made if substantially all disclosures are omitted.
d. Incorrect. The term "generally considered" is not used for tax-basis financial statements. Instead, the term "ordinarily included" is used within AR-C 70.

15. Which of the following is an item that should be documented in a preparation of financial statements engagement under AR-C 70:
    a. Correct. AR-C 70 states that an accountant's documentation should include a copy of the financial statements that the accountant prepared.
    b. Incorrect. There is no accountant's preparation report making the answer incorrect. If there were a disclaimer report, it would be included. However, a "preparation report" is identified, not a "disclaimer report."
    c. Incorrect. AR-C 70 does not conclude that a preparation checklist should be documented or even used, making the answer incorrect.
    d. Incorrect. AR-C 70 does not require that an accountant obtain a management representation letter in a preparation engagement. Thus, the answer is incorrect.

Glossary

Analytical procedures: Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Applicable financial reporting framework: The financial reporting framework adopted by management and, when appropriate, those charged with governance, in the preparation and fair presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements or that is required by law or regulation.

Basic financial statements: Financial statements excluding supplementary information and required supplementary information.

Designated accounting standard-setter: A body designated by the Council of the AICPA to promulgate accounting principles generally accepted in the United States of America pursuant to Rule 202, *Compliance with Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), and Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01), of the AICPA Code of Professional Conduct.

Emphasis-of-matter paragraph: A paragraph included in the accountant's review report that is required by SSARSs, or is included at the accountant's discretion, and that refers to a matter appropriately presented or disclosed in the financial statements that, in the accountant's professional judgment, is of such importance that it is fundamental to the users' understanding of the financial statements.

Engagement partner: The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal, or regulatory body.

Engagement team: All partners and staff performing the engagement and any individuals engaged by the firm or a network firm who perform procedures on the engagement.

Error: Mistakes in the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.

Experienced accountant: An individual (whether internal or external to the firm) who has practical review experience, and a reasonable understanding of review processes, SSARSs and applicable legal and regulatory requirements, the business environment in which the entity operates, and review and financial reporting issues relevant to the entity's industry.

Financial reporting framework: A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, U.S. GAAP, International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

Financial statements: A structured representation of historical financial information, including related notes, intended to communicate an entity's economic resources and obligations at a point in time or the changes therein for a period of time in accordance with a financial reporting framework. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The term financial statements ordinarily refers to a complete set of financial statements as determined by the requirements of the applicable financial reporting framework but can also refer to a single financial statement.

Firm: A form of organization permitted by law or regulation whose characteristics conform to resolutions of the Council of the AICPA and that is engaged in the practice of public practice.

Fraud: An intentional act that results in a misstatement in financial statements.

Interpretative publications: Interpretations of SSARSs; exhibits to SSARSs; AICPA Guide *Preparation, Compilation, and Review Engagements*, guidance on preparation, compilation, and review engagements included in AICPA Audit and Accounting Guides; and AICPA Statements of Position, to the extent that those statements are applicable to such engagements.

Management: The person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance (for example, executive members of a governance board or an owner-manager).

Misstatement: A difference between the amount, classification, presentation, or disclosure of a reported financial item in the financial statements and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from fraud or error.

Noncompliance: Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to prevailing laws or regulations. Such acts include transactions entered into, by, or in the name of, the entity or on its behalf by those charged with governance, management, or employees. *Noncompliance* does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management, or employees of the entity.

Other-matter paragraph: A paragraph included in the accountant's review report that is required by SSARSs, or is included at the accountant's discretion, and that refers to a matter other than those presented or disclosed in the financial statements that, in the accountant's judgment, is relevant to users' understanding of the review, the accountant's responsibilities, or the accountant's review report.

Other preparation, compilation and review publications: Publications other than interpretative publications. including: AICPA preparation, compilation, and review publications not defined as interpretive publications, AICPA's annual alert addressing engagements performed in accordance with SSARSs, articles addressing preparation, compilation, and review engagements in the Journal of Accountancy and other professional journals, *continuing professional education programs and other instruction materials,* textbooks, guide books, programs for preparation, compilation, and review engagements, checklists, and other publications addressing preparation, compilation, and review engagements from state CPA societies, other organizations, and individuals.

Professional judgment: The application of relevant training, knowledge, and experience, within the context provided by SSARSs, accounting and ethical standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the preparation, compilation, or review engagement.

Prospective financial information: Any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Report release date: The date the accountant grants the entity permission to use the accountant's review report in connection with the financial statements.

Required supplementary information: Information that a designated accounting standard-setter requires to accompany an entity's basic financial statements. Required supplementary information is not part of the basic financial statements; however, a designated accounting standard-setter considers the information to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. In addition, authoritative guidelines for the methods of measurement and presentation of that information have been established.

Review documentation: The record of review procedures performed, relevant review evidence obtained, and conclusions the accountant reached (terms such as *working papers* or *workpapers* are also sometimes used).

Review evidence: Information used by the accountant to provide a reasonable basis for the obtaining of limited assurance.

Special purpose framework: A financial reporting framework other than generally accepted accounting principles (GAAP) that is one of the following bases of accounting: cash basis, tax basis, regulatory basis, contractual basis, or other basis that utilizes a definite set of logical, reasonable criteria that is applied to all material items appearing in the financial statements.

Specified parties: The intended users of the accountant's review report.

Subsequent events: Events occurring between the date of the financial statements and the date of the accountant's review report.

Subsequently discovered facts: Facts that become known to the accountant after the date of the accountant's review report that, had they been known to the accountant at that date, may have caused the accountant to revise the accountant's review report.

Supplementary information: information presented outside the financial statements, excluding required supplementary information, that is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework.

Those charged with governance: The person(s) or organization(s) (for example, a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. Those charged with governance may include management personnel (for example, executive members of a governance board or an owner-manager).

Updated report: A report issued by a continuing accountant that takes into consideration information that the accountant becomes aware of during the accountant's current engagement and that re-expresses the accountant's previous conclusions or, depending on the circumstances, expresses different conclusions on the financial statements of a prior period reviewed by the accountant as of the date of the accountant's current report.

Written representation: A written statement by management provided to the accountant to confirm certain matters or to support other review evidence. Written representations in this context do not include financial statements or supporting books and records.

PDH Academy

SSARS 21 Update Part 1 – Preparation of Financial Statements Engagement

Final Exam

1. Which of the following is a change made in SSARS No. 21 that is carried over from auditing standards:
   a. Engagement letter must be signed by accountant and management
   b. Confirmations must be sent to third parties in a review engagement
   c. Term "income tax basis" is retained
   d. A management representation letter is optional for a review engagement similar to an audit engagement

2. Jimmy CPA is an accountant in a CPA firm who is responsible for a compilation or review engagement. Under SSARS No. 21, Jimmy is considered a(an) ____________.
   a. Engagement partner
   b. Staff person
   c. Engagement consultant
   d. Accounting manager

3. Which of the following is an engagement type that is *not* a type of engagement that is authorized under SSARS No. 21:
   a. Audit engagement
   b. Preparation of financial statements engagement
   c. Compilation engagement
   d. Review engagement

4. Mary Smith is an accountant who performs a review engagement for her client, Wild Bill's Saddle Company. Mary prepares financial statements as well as performing a review engagement for her client. The financial statements belong to ______________.
   a. The accountant
   b. The entity
   c. The third-party user of those financial statements
   d. The party who both prepares the financial statements and also takes responsibility for those statements

5. An example of a word(s) that indicates that there is an unconditional requirement that must be followed by an accountant is which of the following:
   a. Must
   b. Should
   c. Might consider
   d. Cannot

6. AR-C 70 treats the preparation of financial statements as a(an) ______________.
   a. Nonattest service in all cases
   b. Attest service in all cases
   c. Attest service if performed in conjunction with a review or audit engagement
   d. Nonattest service only if performed as part of a compilation engagement

7. Big Bruce Batton CPA is hired to prepare monthly financial statements for nine months, and then is hired to perform an audit engagement for the annual financial statements. How should the nine monthly engagements be handled under SSARS No. 21
   a. AR-C 70 preparation standards apply to each of the nine monthly engagements
   b. AR-C 90 review standards apply to each of the nine monthly engagements
   c. AR-C 80 compilation standards apply to each of the nine monthly engagements
   d. None of the SSARS standards apply to the nine monthly engagements

8. The cash, tax, regulatory and other bases of accounting are examples of which of the following:
   a. Generally accepted accounting principles
   b. Special purpose framework
   c. Contractual basis of accounting
   d. CTR basis of accounting (cash, tax and regulatory basis)

9. Ralph Crammer is an accountant. What has to happen in order for Ralph to perform a preparation of financial statements engagement:
   a. Ralph must be engaged (hired) to prepare financial statements
   b. Ralph must be forced to prepare financial statements because he has submitted financial statements
   c. Ralph must makes journal entries to the general ledger
   d. Ralph must link general ledger accounts to financial statement line items

10. Sally Fields is a CPA who is performing a preparation of financial statement engagement under AR-C 70. Which of the following is true with respect to peer review:
    a. Sally is most likely not subject to peer review as long as the only engagements she performs are preparation engagements
    b. Sally is not subject to peer review as long as Sally only performs preparation and compilation engagements, and avoids review and audit engagements
    c. Sally is mostly likely subject to peer review even if the only engagements she performs are preparation of financial statement engagements
    d. Sally has the option of participating in a peer review program if she performs both preparation, compilation and review engagements

11. Joan Arch CPA is performing a preparation of financial statements engagement under AR-C 70. Which of the following is the type of report that must be issued for this type of engagement:
   a. No report is issued in most cases
   b. An abbreviated compilation report is issued
   c. A special preparation report is issued
   d. The accountant has an option to issue either a compilation or review report for the preparation engagement

12. Ronald Reagan is performing a preparation of financial statements engagement under AR-C 70. Management refuses to include a legend on each page of the financial statements. What are the accountant's options under AR-C 70:
   a. Accountant may type in his or her own legend on each page of the financial statements
   b. Accountant should issue a disclaimer report
   c. Accountant is not required to do anything as a preparation engagement is a plain-paper engagement
   d. Accountant must withdraw from the engagement

13. If a description of a special purpose framework is presented on the face of the financial statements, which of the following is an acceptable location where the description can be presented:
   a. Next to the title of the financial statement such as "balance sheet-tax basis"
   b. Only under the title of the financial statements but not next to the title
   c. Must be presented only at the bottom of the financial statement under the legend, if there is a legend
   d. There is no requirement to include a description on the face of the financial statements as it must be presented in the notes to financial statements

14. Emma Rockwell is an accountant who is performing a preparation of financial statements engagement under AR-C 70. The GAAP financial statements omit a statement of cash flows which is a GAAP departure. Which of the following is true:
   a. Emma is not required to do anything
   b. Disclosure of the misstatement (GAAP departure) must be made in a note to financial statements or on the face of the financial statements
   c. A disclosure of the misstatement should not be disclosed on the face of the financial statements
   d. A disclosure of the misstatement should not be disclosed in the notes to the financial statements

15. Which of the following is true as to whether an accountant is permitted to include in a disclaimer report the disclosure about a GAAP departure and/or omission of disclosures:
    a. There is authority within AR-C 70 that permits an accountant to include in a disclaimer report, a disclosure of a GAAP departure
    b. There is authority within AR-C 70 that permits an accountant to include in a disclaimer report a disclosure about the omission of disclosures
    c. There is no authority that permits an accountant to include in a disclaimer report, a disclosure for either a GAAP departure or an omission of disclosures
    d. An accountant is required, rather than permitted, to include in a disclaimer report, a disclosure of a GAAP departure or an omission of disclosures

16. An accountant is preparing financial statements on the tax basis. A statement of cash flows is not included. What kind of legend should be included to reflect the fact that a statement of cash flows is *not* included:
    a. No legend is required. A statement of cash flows is not required under the tax basis of accounting
    b. A legend should be included stating that there is a GAAP departure
    c. A comment must be made in the notes to financial statements
    d. A legend is required only on the balance sheet, but not the income statement

17. Which of the following is an item that should be documented in a preparation of financial statements engagement under AR-C 70:
    a. Analytical procedures performed
    b. Inquiries made of management by the accountant
    c. Engagement letter
    d. Confirmations received from outside third parties

18. With respect to a preparation of financial statements engagement under AR-C 70, an engagement letter ____________________:
    a. Should be signed by the accountant but not by management or those charged with governance
    b. Should be signed by both the accountant and management or those charged with governance
    c. Does not have to be signed
    d. Should be signed by management but not by the accountant

19. Which is true with respect to whether an accountant who uses a disclaimer report, is permitted to include a legend on each page of the financial statements stating "See Disclaimer Report":
    a. An accountant is not permitted to include a "See Disclaimer Report" legend
    b. Nothing precludes the use of a legend such as "See Disclaimer Report" on each page of the financial statements
    c. An accountant may use the legend as long as he or she inserts the word "Accountant" in the legend
    d. The legend may be used only if the accountant includes a title on the report "Disclaimer Report"

20. ASC 274 (formerly SOP 82-1) requires that assets on personal financial statements be stated at their:
    a. Amortized cost
    b. Replacement cost
    c. Estimated current values
    d. Net realizable value