Guide and Update to Compilations, Reviews, and Preparations

CRU4/26/V1-P1

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Overall Learning Objectives

- After completing this course, you should be familiar with:
  - Accepting, planning, performing, and reporting on preparation, compilation, and review engagements in accordance with the SSARS;
  - Independence requirements for SSARS engagements;
  - Several other financial reporting frameworks used in preparation, compilation, and review engagements;
  - Presentation, compilation, and review programs, disclosure illustrations, and accountant's reports; and
  - Other changes brought by recently issued SSARS

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Course Outline

- Chapter 1 – Introduction to Financial Statement Preparation, Compilation, and Review Engagements
- Chapter 2 – Independence Considerations for Performing SSARS Engagements
- Chapter 3 – AR-C 60: General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services
- Chapter 4 – AR-C 70: Performing Financial Statement Preparation Services
- Chapter 5 – AR-C 80: Performing and Reporting on Compilation Engagements
- Chapter 6 – AR-C 90: Performing and Reporting on Review Engagements

A Quick Word on Policy vs. Politics

- Many times when discussing accounting, tax and finance policy issues, it can be difficult to divorce the politics from the policy
- Today, when discussing the various issues we will encounter over the next several hours, let's agree to keep our own view of politics out of the application of the policy and focus on doing the very best we can for all our clients
- This goes for religious/faith views as well

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Chapter 1

Introduction to Financial Statement Preparation, Compilation, and Review Engagements

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Chapter Learning Objectives

- After completing this chapter, you should be familiar with:
  - The concepts that provide a basic framework for performing and reporting on financial statement preparation, compilation, and review engagements;
  - The changes implemented with Statements on Standards for Accounting and Review Services No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, as well as changes brought by SSARS No. 22, *Compilation of Pro Forma Financial Information (AR-C section 120)*, and SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services – 2016* and SSARS No. 24, *Omnibus Statement on Standards for Accounting and Review Services – 2018*;
  - Changes to the SSARS guidance with the recent issuance of SSARS No. 25, *Materiality in a Review of Financial Statements and Adverse Conclusions*;
  - Changes to SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services*; and
  - SSARS No. 27, *Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services Engagement*

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Changes in Standards for Accounting and Review Services

- SSARS No. 22, *Compilation of Pro Forma Financial Information* (AR-C section 120):
  - Issued in September 2016
  - Recodified standards on performing compilation engagements on pro forma information
- SSARS No. 23, *Omnibus Statement on Standards for Accounting and Review Services – 2016*:
  - Issued in October 2016
  - Narrowed scope changes to guidance concerning supplementary data
  - Made conforming changes to allow guidance on compilation of Prospective Financial Information to transfer to the SSARS

Recently Issued SSARS

- SSARS No. 24, *Omnibus Update – 2018*
  - Adds AR-C section 100 to SSARS Codification
  - Adds guidance on consideration of going concern issues on AR-C section 90 engagements
  - Makes other changes to AR-C section 60
- SSARS No. 25, *Materiality in a Review of Financial Statements and Adverse Conclusions*
  - Conforms guidance in AR-C Section 90 to international review standards
  - Adds audit concepts, as applicable to SSARS engagements
  - Effective for engagements for years ending on or after December 15, 2021
- SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services*
  - Issued in June of 2022. Adds audit concepts, as applicable, to SSARS engagements
  - Enhances concepts related to quality management for engagements performed in accordance with SSARS
  - Effective for engagements for periods beginning on or after December 15, 2025

Recently Issued SSARS

- SSARS No. 27, *Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services Engagement*
  - Amends scope paragraphs of AR-C section 70 to clarify that the accountant is not required to apply (but not precluded from applying) AR-C section 70 when financial statements are prepared: (a) as part of a consulting services engagement under CS section 100 where preparation is not the primary objective; (b) as part of a personal financial plan under PFP section 100; (c) as part of a business valuation under VS section 100; (d) solely for submission to taxing authorities; or (e) in conjunction with litigation services
  - Effective for the preparation of financial statements for periods ending on or after December 15, 2026
    - Early implementation is permitted

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SSARS

- Statements on Standards for Accounting and Review Services (SSARS)
- Issued by the Accounting and Review Services Committee – Formed in 1977
- AICPA *Code of Professional Conduct* required:
  - Attest service that requires independence
- Compilation is ***not*** an assurance service
  - However, we must still disclose a lack of independence
    - No such disclosure is required for preparations
  - Review and audits **are** assurance services
    - Independence is required!

SSARS No. 21: Clarification and Recodification

- SSARS No. 21 supersedes virtually all existing AR sections in the AICPA Professional Standards
- Comprises four sections:
  - Section 60 – General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services
  - Section 70 – Preparation of Financial Statements
  - Section 80 – Compilation Engagements
  - Section 90 – Review of Financial Statements

Objectives of Preparation, Compilation, and Review Engagements

- Financial statement user needs drive engagement objectives:
  - Preparation of financial statements
    - Nonattest service of preparing financial statements pursuant to a financial reporting framework
  - Compilation
    - Assisting management in presenting financial information in form of financial statements
    - Compilations are <u>not</u> assurance engagements
  - Review
    - Obtaining "limited" assurance that financial statements are not materially misstated
    - "Limited" is not defined

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Characteristics of SSARS Engagements

- Financial statement preparation, compilation, and review engagements **DO NOT** involve:
  - Obtaining an understanding of entity’s internal control system
  - Assessing the risk of fraud
- SQCS No. 8, *A Firm’s System of Quality Control* (QC No. 10):
  - You/firm responsible for establishing QC policies and procedures that provide reasonable assurance for complying with SSARSs
  - SSARS No. 26, SQMS No. 1, and SQMS No. 2 have replaced QC Section 10 – Effective December 15, 2025. Details are covered in Chapter 3 of this course
- Maintain objectivity and integrity:
  - AICPA *Code of Professional Conduct*

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Other Financial Statement Preparation, Compilation, and Review Resources

- Nonauthoritative application-based guidance:
  - CPE materials
  - Compilation and review programs and checklists
  - Articles in professional journals
  - Textbooks
- Accountant can refer to for industry guidance

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Components of Preparation, Compilation, and Review Engagements

- Players
- Applicable financial reporting framework
- Financial statements
- Review engagement – Review procedures and review evidence
- Written compilation or review report

The Players

- Management:
  - Preparation and fair presentation of financial statements
  - Designing, implementing, and maintaining internal control
- CPA:
  - Preparing, compiling, or reviewing financial statements – Requires knowledge and competence to perform engagement
- Intended users:
  - Understand limitations of prepared, compiled, or reviewed financial statements

The Applicable Financial Reporting Framework

- Accounting principles and policies that determine form and content of financial statements:
  - U.S. GAAP
  - Special Purpose Frameworks – Cash and tax bases of accounting
  - Others – Explored later in the course
- Pro forma and prospective financial statements should be prepared using the same framework as the underlying financial statements

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The Financial Statements

- Full set, individual financial statement, or individual elements of financial statements
- Depends on requirements of applicable financial reporting framework management has chosen:
  - Under "pure" cash basis of accounting entity typically only prepares a Statement of Cash Receipts and Cash Disbursements

Moose Lake Homeowners Association

Statements of Cash Receipts and Cash Disbursements

(Please See Text)

Written Compilation or Review Report

- Accountant required to issue written report on financial statement compilation or review engagements
- Independence not required to perform and report on preparation or compilation – have to disclose in compilation report:
  - I am not independent with respect to Company X
  - I am not independent with respect to Company X as of and for the year ended December 31, 20X1, because I performed certain accounting services that impaired my independence
- Have to be independent to perform and report on review

Materiality

- Just as applicable to preparation, compilations, and reviews as it is to audits
- Materiality is considered in the context of the applicable financial reporting framework
  - It's material if it would influence a user's decision-making process regarding the financial statements
  - Considered both individually and in the aggregate
- Determining materiality is matter of professional judgment
  - Judgments made in the context of engagement facts and circumstances
  - Considered from the perspective of users as a group
- SSARS No. 25 adds the requirement to explicitly determine and apply materiality threshold on review engagements

U.S. GAAP

- If used in preparation or compilation – Same U.S. GAAP used in review and audit:
  - How U.S. GAAP is applied is not a function of the level of assurance provided in a particular engagement
  - If there are U.S. GAAP departures in compiled F/Ss you may need to modify compilation report

"Final Read"

- Financial statements conform with financial reporting framework used
- No obvious errors:
  - Typos, math, application of accounting principles, inadequate disclosures
- Objective:
  - To make sure you do not associate yourself with misleading financial statements (which is an ethics violation)
- If you conclude financial statements are misleading:
  - Withdraw from engagement

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Review Procedures and Review Evidence

- Perform review procedures to obtain review evidence
- Your conclusion (*not opinion*) whether F/S are materially misstated
- Specific review procedures (nature, timing, and extent) matter of professional judgment
- Should be tailored to engagement
- Analytical procedures and inquiries:
  - Will generally provide review evidence needed to obtain limited assurance
- Obtain Management Representation Letter
- Greater documentation requirements, including consideration of materiality

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Applying What You've Learned

Discussion Question:

What are the major quality issues your firm faces when performing SSARS engagements?

Chapter 2

Independence Considerations for Performing SSARS Engagements

Chapter Learning Objectives

- After completing this chapter, you should be able to:
  - Explain how to identify and safeguard independence threats for attest services;
  - Differentiate attest from nonattest services; and
  - Understand recent updated PEEC guidance and interpretations

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The Cornerstones of Professionalism

- Integrity:
  - Consistent application of morals, values, and principles
  - Honesty and truthfulness of an individual's decisions and actions
  - The ultimate quality against which a CPA must test decisions and actions
  - Cannot condone deceit or subordination of moral or ethical principle

The CPA must always act honestly and with the utmost truthfulness

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Due Care

- Due care is:
  - Having adequate technical knowledge
  - Performing in a diligent manner
- But, for a CPA, it also requires:
  - Observing profession's ethical standards
  - Striving for continuous improvement

CPA's Integrity in Action

- A CPA advances the public interest by doing the following:
  - Practicing in a firm with quality management standards in place
  - Using judgment to avoid conflicts of interest
  - Assessing whether an activity is consistent with their role as a CPA
  - Never subordinating the public trust for personal gain

A CPA must be willing to "walk the talk"

Objectivity as a State of Mind

- Free of conflicts of interest
- Not knowingly misrepresent facts
- Not subordinate their judgment to others
- Obligation to be impartial, intellectually honest, and free of conflicts of interest

No matter your role as a CPA, you have the same ethical responsibility to be objective

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Conflicts of Interest

- AICPA's *Code of Professional Conduct* requires a member to be "free of conflicts of interest"
- Conflicts may occur in the event of a relationship with a person, entity, product, or service that could be seen as impairing a person's objectivity
- Relationship must be disclosed and consented to
- Disclosure and consent can't overcome independence requirement, when applicable

Identifying Conflicts of Interest in Public Practice

- A conflict of interest may arise when a CPA's service could be influenced by personal or competing interests
- CPAs must use professional judgment and consider whether a reasonable, informed third party would perceive a conflict
- Two key threats:
  - Adverse interest threat – The CPA's interests oppose the client's, risking objectivity
  - Self-interest threat – The CPA may personally benefit, financially or otherwise

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Common Conflict Scenarios

- Examples of conflicts:
  1. Representing multiple parties with opposing interests in the same matter
  2. When the CPA’s interests – or those of close family – conflict with the client’s
- Reminder – Professional judgment must always be exercised, guided by how an informed third party would view the situation. This supports compliance with the integrity and objectivity rule

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AI and Ethical Considerations

- The AICPA's Emerging Technology Ethics Task Force has addressed risks tied to AI and data analytics
- CPAs must ensure:
  - Fairness and accuracy of AI-generated insights
  - Disclosure when AI plays a material role in conclusions (for example, revenue forecasts)
- CPAs must not use AI to make management decisions for attest clients, which violates section 1.295
- These safeguards uphold the integrity and objectivity rule (ET section 1.100.001) by promoting honesty, transparency, and independence

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Independence: A Conceptual Framework

- Risk-based approach to analyze independence matters:
  - Used by AICPA's Professional Ethics Executive Committee (PEEC)
  - Relationship evaluated to see if "unacceptable risk"
- Risk is unacceptable if relationship would compromise or be perceived as compromising professional judgment
- Framework requires:
  - Identification and assessment of the threat to independence
  - Determining if the threat compromises independence
  - Determining if threat can be effectively mitigated or eliminated

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Attest Client-Implemented Safeguards to Independence

- Personnel with skills, knowledge, and experience to make managerial decisions on attest engagement
- Tone at the top
- Policies and procedures to achieve fair financial reporting
- Effective governance structure
- Policies dictating types of services purchased

Displays a high level of competence with regard to engaging and managing attestation services

Firm-Implemented Safeguards

- Firm leadership that stresses importance of independence
- Strong policies and procedures governing all aspects of independence:
  - Including monitoring and enforcement
- Effective staffing, including partner and staff rotation
- Effective communications:
  - Internally for staff and partners
  - With clients
- Effective peer or other external review function

The AICPA's Independence Rule

1.200 Independence

1.200.001 Independence Rule

.01 A *member* in public practice shall be independent in the performance of *professional services* as required by standards promulgated by bodies designated by *Council*. [Prior reference: paragraph .01 of ET section 101]

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The Independence Rule

- Found in the AICPA's *Code of Professional Conduct*
- Supplemented by SEC, PCAOB, DOL, GAO, or other regulatory requirements
- Rule incorporates all independence interpretations and ruling of the AICPA's Professional Ethics Executive Committee (PEEC):
  - Provide guidance about scope and application of rules
  - Published in *Journal of Accountancy*
  - Member must justify a departure in a disciplinary hearing

AICPA *Independence Rule Independence Interpretations*

1.220	Accounting Firms	1.250	Participation in Employee Benefit Plans	1.277	Former Employment or Association with Attest Client
1.224	State and Local Government Affiliates	1.255	Depository, Brokerage, and Other Accounts	1.280	Memberships
1.226	Reissued Reports	1.257	Insurance Products	1.285	Gifts and Entertainment
1.228	Engagement Contractual Terms	1.260	Loans, Leases, and Guarantees	1.290	Actual or Threatened Litigation
1.230	Fees	1.265	Business Relationships	1.295	Nonattest Services
1.240	Financial Interests	1.270	Family Relationships with Attest Clients	1.297	Independence Standards for Engagements Performed in Accordance with SSAEs
1.245	Trusts and Estates	1.275	Current Employment or Association with Attest Client	1.298	Breach of an Independence Interpretation

Who Is a Covered Member?

- May or may not be a CPA:
  - Member of the attest team
  - Individual in a position to influence the attest engagement
  - Firm partner or manager providing more than 10 hours of nonattest services to an attest client
  - Partner or equivalent in the practice office
  - The firm, including firm benefit plans
  - An entity whose operating, financial, or accounting policies can be controlled by any of the above

These people are subject to the Independence Rule and its interpretations

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Independence Concerns for Non-Covered Members

- The following relationships impair your independence, even as a non-covered member of a public accounting firm:
  - Firm professionals who are either a director, officer, or employee of a client, promoter, underwriter, voting trustee, or trustee of the client's employee benefit plan
  - Owner of more than 5 percent of any attest client's outstanding equity or other ownership interest
- These are prohibited relationships for partners or professional employees of public accounting firms

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So, What Does It Mean for Management to Take Responsibility?

- No safeguards can mitigate independence impairment caused by assuming the role of management
- Management consists of:
  - Setting policy or strategic direction
  - Directing and accepting responsibility
  - Authorizing, executing, or consummating a transaction
  - Preparing source documents
  - Having custody of assets
  - Deciding which recommendations to implement
  - Accepting responsibility for managing project; preparing financial statements; and designing, implementing, and monitoring internal controls

Breach of Independence Interpretation

- Section 1.298 of the Code:
  - Provides flexibility when a breach of independence occurs
  - Previously required engagement termination in all cases
- Current interpretation offers a framework for evaluating and addressing breaches
- Allows a firm to conclude a breach can be remediated if specific criteria are met
- Termination of engagement remains an option when threats cannot be reduced to an acceptable level

Applying the Interpretation

- To apply this interpretation, a firm must:
  - Be in compliance with SQMS No. 1, *A Firm's System of Quality Management*
  - Maintain policy and procedures that:
    - Communicate independence requirements to personnel
    - Identify and assess independence threats
    - Include timely actions, including withdrawal
- No relief if independence breach affects integrity, objectivity, or professional skepticism
- If partner commits or fails to report a known breach, rebuttable presumption that breach can't be addressed appropriately

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Dealing With Identified Breaches

- Communicate timely to responsible party and those taking action
- Action causing breach should be terminated
- Assess the significance of the breach:
  - Nature, duration, and extent of breach on threats
  - Number and nature of other breaches at the attest client
  - Role of individual causing breach and knowledge of it
  - The effect of the breach on the accounting records
  - Knowledge of partner and whether the partner acted
- Must answer the question if satisfactory action can be taken:
  - Reasonable and informed third party should reach same conclusion

Remedies Short of Termination

- The following are remedies short of termination of engagement:
  - Removing relevant individual from attest engagement team
  - Conduct additional review or reperform with different personnel
  - Recommend attest client engage another firm to review or reperform work
  - Engage another firm to evaluate results of or reperform nonattest service, if breach relates to services impacting accounting records or financial statements
- Actions should be communicated in writing to client and adequately documented

Recently Enacted PEEC Interpretations

- Revisions to Engagements Subject to the Statements on Standards for Attestation Engagements
- ET section 1.275.005
  - Simultaneous Employment or Association With an Attest Client
    - Effective as of September 15, 2026, with early adoption permitted
- ET sections 1.230.030 and 1.230.040
  - Determining Fees for an Attest Engagement
  - Fee Dependency
- ET section 1.295.135
  - Executive or employee recruiting
- ET section 1.240.070
  - Section 529 Plans
- ET section 1.295.160 (Proposed)
  - Tax Services – proposed revisions to address advocacy threats

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New Definition and Technical Wording Changes for Section 1.220.030

- **Period covered by the attest report** – The point in time or period of time to which the subject matter of the *attest engagement* relates. The period covered by the attest report can vary depending on the scope of the *attest engagement*.
- Also replaces much of the language focused on audit standards with “professional standards applicable to the attest engagement, such as AU-C…”
- Replaces “audit” with “attest” throughout the Code section
- Effective as of June 15, 2026

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Period Covered by the Attest Report – Examples

Examples of engagements performed in accordance with Statements on Auditing Standards or Statements on Standards for Accounting and Review Services	Examples of engagements performed in accordance with Statements on Standards for Attestation Engagements
i. The fiscal- or calendar-year period covered by an audit or review report on a complete set of *financial statements*, such as "as of and for the year ended December 31, 20X0" ii. The single day covered by an audit or review report on a balance sheet, such as "as of December 31, 20X0"	i. The six-month period covered by an examination report on the controls at a service organization, such as "for the six-month period ending September 30, 20X0" ii. The fiscal- or calendar-year period covered by an examination or review report on greenhouse gas emissions information, such as "for the year ended December 31, 20X0"

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ET Section 1.275.005 – Simultaneous Employment or Association With an Attest Client

- New definition added to the Code: **Simultaneously employed or associated**
- "When a *partner* or professional employee of the *member's firm* serves as a member of *those charged with governance* or as an employee of an *attest client* during the *period of the professional engagement.* This includes contractual or volunteer positions at the *attest client"*

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ET Section 1.275.005 – Threats to Independence

- "The familiarity, management participation, advocacy, self-interest, or self-review *threats* to compliance with the 'Independence Rule' would **not** be at an *acceptable level* and could **not** be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when:
  - A *covered member* is *simultaneously employed or associated* with the *attest client*; or
  - A *partner* or professional employee who is not a *covered member* is *simultaneously employed or associated* in a *key position* with the *attest client*"
    - *"Key position"* term replaces former "officer or director" language

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ET Section 1.275.005 – Threats to Independence

- "When a partner or professional employee intends to accept an offer to become simultaneously employed or associated with an attest client:
  - The person should promptly report the offer to an appropriate person in the firm; and
  - The appropriate person should apply the 'Conceptual Framework for Independence' interpretation [1.210.010] to evaluate whether the familiarity, management participation, advocacy, self-interest, and self-review threats are at an acceptable level"
- An inadvertent and isolated failure to apply the above will not impair independence if the impacted parties perform the required procedures upon discovery of the failure and continue to meet the rest of the standard in section 1.275

ET Section 1.275.005 – Threats to Independence

- Factors to consider if the threat is at an acceptable level:
  - **The person's position and role at the attest client** – The more responsibility and visibility, the higher the threat
  - **The person's position and role at the firm** – The more significant, the higher the threat
  - **Level of assurance of the attest engagement** – Audit clients likely present a higher threat than other assurance engagements
  - **Nature and scope of the activity to be performed**
  - **Size and structure of the attest client** – The smaller the client, the larger the threat
  - **Length and status of the simultaneous employment/arrangement** – The longer/full-time association is riskier than a short-term/temporary position
  - **Value of compensation paid to the member** – If material to the member's net worth, the threat is higher

ET Section 1.275.005 – Safeguards to Threats

- Examples of actions that may be safeguards:
  - Designating an appropriate reviewer who has not provided services to the attest client to review the attest work performed
  - Modifying the individual's position or role at the attest client sufficiently that threats to independence are reduced to an acceptable level
- ***Note:*** Communication with those charged with governance regarding threats is a safeguard but is not a sufficient safeguard on its own. It must be applied with other safeguards like those listed above

ET Section 1.275.005 – Independent Contractors

- When an employee of an attest client is engaged as an independent contractor (IC) by the firm to perform professional services for the attest client, independence **would be impaired** if the same employee is **any** one of the following:
  - A member of the attest engagement team for the same attest client
  - An individual in a position to influence the attest engagement for the same attest client
  - In a key position at the same attest client
  - Serving in a role held by those charged with governance at the same attest client

ET Section 1.275.005 – Exceptions to the Rule

- Threats will be at an acceptable level, and independence is not impaired when:
  - A partner or professional employee of the member's firm serves as an adjunct faculty member of an educational institution that is an attest client of the firm, and the partner or professional employee meets all the following safeguards:
    - Is not in a key position or in a role held by those charged with governance at the educational institution
    - Is not a member of the attest engagement team
    - Is not an individual in a position to influence the attest engagement
  - A member in a government audit organization performs an attest engagement with respect to the government entity, and the head of the government audit organization meets at least one of the following criteria:
    - Is directly elected by voters of the government entity with respect to which attest engagements are performed
    - Is appointed by a legislative body and is subject to removal by a legislative body
    - Is appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body and removal is subject to oversight or approval by the legislative body

ET Section 1.230.030 – Determining Fees for an Attest Engagement

- The “Determining Fees for an Attest Engagement” interpretation (ET section 1.230.030) is designed to ensure the process of setting fees for an attest client remains unaffected by any other services rendered to that client, emphasizing that the fee for an attest engagement should be considered independently from the total fees charged to the client for various services
- This aims to prevent other services from influencing the fee of an attest engagement

ET Section 1.230.040 – Fee Dependency

- The “Fee Dependency” interpretation (ET section 1.230.040) addresses the self-interest and undue influence risks that occur when a significant portion of a firm’s revenue is derived from a single attest client
- This guidance aids firms and covered members in assessing and mitigating independence risks associated with substantial fee dependency on an attest client, which could lead to concerns over losing the client and undue influence threats

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Fee-Related Independence Threats

- To help members identify fee-related independence threats, PEEC has enhanced the “Conceptual Framework for Independence” (ET section 1.210.010) with updated examples of threats
- The “Client Affiliates” interpretation (ET section 1.224.010) has also been revised to clarify the affiliates subject to the fee-dependency requirements
- Changes became effective January 1, 2025

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Executive or Employee Recruiting – ET Section 1.295.135

- Issued by PEEC on June 10, 2024
- Addresses independence threats when members assist attest clients with recruiting services
- Prohibits:
  - Advising on specific employment terms, pay, or benefits
  - Searching for candidates
  - Conducting reference checks
  - Recommending only one candidate for consideration
- Aims to prevent undue influence and familiarity threats
- Emphasizes that hiring decisions must remain with client management
- Effective January 1, 2026

Tax Services – ET Section 1.295.160 (Proposed)

- In June 2024, PEEC proposed revisions to the Tax Services interpretation (ET section 1.295.160)
- In September 2025, PEEC reexposed revised proposed revisions – final standard not yet issued
- Focus is on mitigating advocacy threats when CPAs provide tax advisory and planning services to attest clients
- Factors for evaluating advocacy threats include:
  - Complexity of the tax regime
  - Degree of judgment involved
  - Materiality of the advice on the financial statements
  - Client's tax expertise
- Aims to align with international standards and provide clearer guidelines for managing independence in tax services

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ET Section 1.240.070 – Section 529 Plans

- A 529 plan is a tax-advantaged savings plan designed to help families save for education expenses
  - Represents an investment vehicle for future qualified education expenses
  - Plans may be:
    - Prepaid tuition plans
    - Savings plans
  - The plan designation impacts the independence interpretation
  - Account owner can designate themselves or another individual as the beneficiary and may change this designation over time
- The updated interpretation was effective as of May 31, 2025

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ET Section 1.240.070 – Section 529 Plans – Prepaid Tuition Plans

- The account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan. Accordingly, if the plan is an attest client, **independence would be impaired if a covered member is an account owner**
- With respect to the plan's underlying investments, the account owner does **not have any financial interests**

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ET Section 1.240.070 – Section 529 Plans – Savings Plans

- The interpretation finds that the account owner's interest in the **savings** plan's underlying investments constitutes an **indirect** financial interest rather than a direct one
  - Prior guidance classified the underlying investment as a **direct** investment
- When the underlying investments in an account owner's Section 529 savings plan do not include an attest client, there are no threats to independence
- When an underlying investment in an account owner's Section 529 savings plan is an attest client, threats to independence may exist if the account owner is a covered member with respect to the underlying investment

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ET Section 1.240.070 – Section 529 Plans – Savings Plans

- If the underlying investment in the attest client is material to the covered member, the self-interest threat would not be at an acceptable level, and independence would be impaired unless the covered member deployed one of the following safeguards:
    1. Reallocating plan holdings such that there is no material indirect financial interest in an attest client for which the member is a covered member
    2. Transferring the account to another sponsor's Section 529 savings plan that does not include a material indirect financial interest in an attest client for which the member is a covered member
    3. Transferring the account to another account owner who is not subject to the "Independence Rule" [1.200.001]
- The safeguard should be applied as soon as practicable but no later than 30 days after the covered member has knowledge of the material indirect financial interest

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PEEC: Responding to Noncompliance With Laws and Regulations

- Ethics interpretation defines a CPA's responsibility to report a known or suspected noncompliance with laws and regulations (NOCLAR) to those inside and outside the client
- Ethics interpretation would converge U.S. ethics standards with IESBA Sections 260 and 360, *Responding to Non-compliance with Laws and Regulations*
- New guidance adds ET sections 1.180 and 2.180 (for CPAs in public practice and in business, respectively)
- Guidance was effective as of June 30, 2023

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Scope of NOCLAR Communications

- What is a NOCLAR?
  - Acts of omission or commission, intentional or unintentional
  - Contrary to prevailing laws or regulations
  - Committed by the following:
    - Client
    - Employer
    - Those charged with governance
    - Management or other individuals working for or under the direction of a client or employer
- Law or regulation violated
  - Generally recognized to have a direct effect on material financial statement amounts or disclosures, or
  - Those which are fundamental to the operating aspects of the client or employing organization
- NOCLARs do not encompass personal misconduct unrelated to the business activities of the client or employing organization

ET Section 1.180 – Responding to NOCLARs

- Objectives when responding to a NOCLAR
  - To comply with the Integrity and Objectivity Rule
  - To alert management or, when appropriate, those charged with governance of the client to enable them to:
    - Rectify, remediate, or mitigate the consequences of the identified or suspected NOCLAR
    - Deter the commission of the NOCLAR when it has not yet occurred
  - To determine whether withdrawal from the engagement is necessary
  - To comply with applicable laws, regulations, and professional standards
  - Disclosure to external authorities is permitted but not required
    - A CPA may disclose without client consent when both conditions are met:
      - Management or those charged with governance fail to take timely remedial action; and
      - The member concludes disclosure is necessary to protect the public interest due to the substantial and systemic nature of the noncompliance

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Scope Exceptions

- Interpretation does not apply to the following:
  - Personal misconduct unrelated to client's business activity
  - Noncompliance by parties other than the client, those charged with governance, management, or others working for or under the client's direction
  - Litigation or investigation engagement under SSFS No. 1
  - An engagement pursuant to which the protections set forth in IRC Section 7525, or any comparable state or local statute, may apply

Additional Scope Exceptions

- In response to comments, the PEEC added the following additional scope exceptions:
  - An engagement where the primary purpose is to identify, reach a conclusion regarding, or otherwise respond to a known or potential NOCLAR
  - A matter otherwise subject to the International Standards for the Professional Practice of Internal Auditing
  - An engagement where compliance with this interpretation would cause a violation of law or regulation

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NOCLAR – CPA Responsibilities and Documentation

- Clarifies CPA responsibilities when identifying actual or suspected illegal acts
- Requires escalation of NOCLAR to senior management or governance when public harm is material
- Allows disclosure to authorities without consent if:
  - Management fails to act, and
  - The issue is substantial and systemic
- Emphasizes documentation of:
  - Communications with management or governance
  - Reasoning for decisions, including withdrawal or external reporting

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Chapter 3

AR-C 60: General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services

Chapter Learning Objectives

- After completing this chapter, you should be familiar with:
  - The general principles for engagements performed in accordance with SSARS AR-C section 60; and
  - The standards that became effective for periods beginning on or after December 15, 2025 (QM section 10 (SQMS 1), QM section 20 (SQMS 2), SAS 146, and SSARS 26)

General Principles for SSARS Engagements – Section 60

- AR-C section 60, *Framework for Performing and Reporting on Compilation and Review Engagements*
- Intended to help accountants better understand professional responsibilities under SSARS engagements:
  - Applies to all SSARS engagements, attest and nonattest
- Includes requirements and guidance with respect to:
  - Defining professional responsibilities
  - Ethical requirements
  - Professional judgment
  - Engagement-level quality management
  - Acceptance and continuance of client relationships/engagements

The AICPA's Statements on Quality Management Standards – Year 2

Standard	Effective Date
SQMS 1 – System of Quality Management	Must be designed and implemented by December 15, 2025. The **evaluation** of the system of quality management is required to be performed within one year following December 15, 2025
SQMS 2 – Engagement Quality Reviews	• Audits or reviews of financial statements for periods beginning on or after December 15, 2025, and other engagements in the firm's accounting and auditing practice beginning on or after December 15, 2025 • The engagement begins when an engagement letter or other agreement to perform attest services is signed or when the firm begins to perform the engagement, whichever is earlier
SAS 146	Engagements conducted in accordance with GAAS beginning on or after December 15, 2025
SSARS 26	Engagements performed in accordance with SSARS beginning on or after December 15, 2025
SQMS 3 – Group Audits	This is the most recently issued standard. Amendments conform certain terms to language used in SAS No. 149 and provide guidance on differentiating between a resource and an information source. Effective concurrently with SQMS 1 and 2, for periods beginning on or after December 15, 2025
SSAE 23	Engagements conducted in accordance with AICPA attestation standards beginning with CYE 2025. SSAE No. 23 was effective for engagements performed in accordance with the attestation standards beginning on or after December 15, 2025

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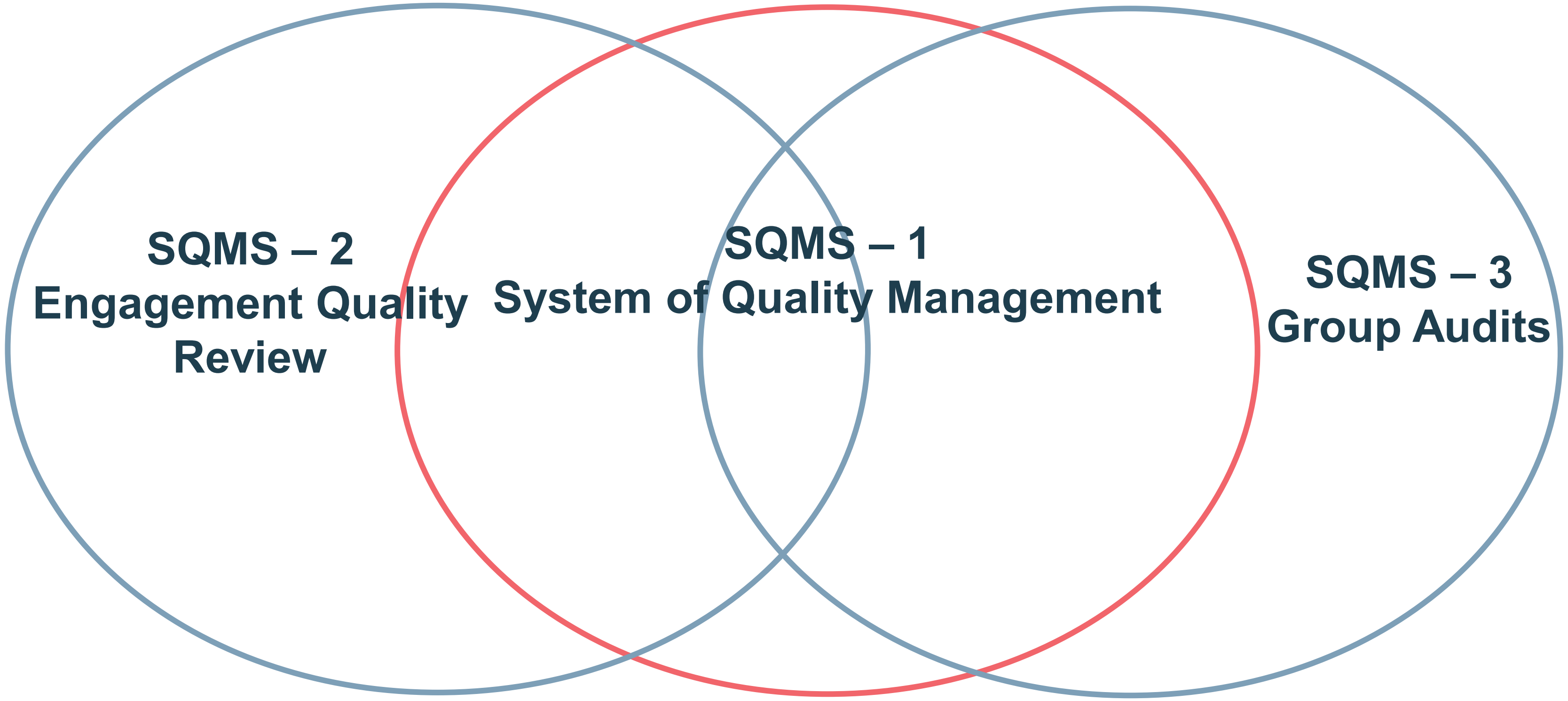
Interrelationship of QM Standards



Quality at the Engagement Level

SSAE 23
QM for Engagements under SSAES

SAS 146
QM for Engagements under SASs

SSARS 26
QM for Engagements under SSARS

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Updated Standards Related to Quality Management – Year 2!

The new standards effectively converge with international and PCAOB Quality Management Standards

Statement of Quality Management Standards 1 and 2

- Instead of one standard, the ASB created two quality management standards and one statement on auditing standard (SAS)
- The ASB believes that separating the topic of quality management from engagement quality reviews helps to underscore the importance of the engagement quality review when deemed appropriate by a firm
- The separation of the standard also clarifies that an engagement quality review can be a response to quality risks for any engagement type, not just audits
- The separation provides a way to differentiate the requirements for the eligibility of the engagement quality reviewer and the performance and documentation of the review

SAS 146 and SSARS 26 on Engagement Quality

- SAS 146 takes the quality principles down to the engagement level for audits; SSARS 26 does so for preparation, compilation, and review engagements
- It discusses how the engagement partner uses the firm's system and manages quality at the engagement level
- The new standard clarifies that the engagement partner has overall responsibility for managing and achieving quality, including creating the appropriate environment for the team focused on ethics, values, and professional skepticism that contributes to a quality engagement
- The engagement partner is ultimately responsible and accountable for compliance with the requirements of the proposed SAS

Leveraging International Standards

- While using the IAASB standard as a base, the ASB also incorporated elements into its proposed standards to be responsive to issues related to audit quality, as noted by peer reviewers and other regulators. The major issues are:
  - Risks to audit quality correlated with audits, reviews, and attestation engagements performed by engagement partners who perform a low volume of such engagements
  - A need to improve firm governance and leadership and the culture and tone at the top of the firm
  - Consistency issues in the performance of engagements and a lack of focus on planning
  - Overreliance on intellectual resources, such as third-party quality management materials, that are not sufficiently tailored to the nature and circumstances of the firm
  - Challenges experienced by smaller firms in applying the standards

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SQMS 1 – Firm's System of Quality Management – Implemented Now

- Standard emphasizes an integrated and iterative approach that focuses on assessing risk and continuous improvement
- Requires a firm to customize its system of quality management rather than tailor a sample document from the firm's practice aids or other sources
- Customize the design, implementation, and operation of firm's system based on the risks that may have impacted engagement quality in the past and the nature and complexity of the firm itself
- Integrated approach is intended to cause firms to focus on the quality management system as a whole rather than focusing on the required components as standalone elements
- The new standard was written to be less prescriptive so that it could be easily scalable
- System of quality management is designed to meet two objectives
  - The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements
  - Engagement reports issued by the firm are appropriate in the circumstances

SQMS 1 – Firm’s System of Quality Management – Implemented Now

The quality management system is required to address:

1. Firm’s risk assessment process (new)
2. Governance and leadership (adapted from the leadership responsibilities for quality within the firm component in QC 10)
3. Relevant ethical requirements (same name as component in QC 10)
4. Acceptance and continuance of client relationships and specific engagements (same name as component in QC 10)
5. Engagement performance (same name as component in QC 10)
6. Resources (adapted from the human resources component in QC 10)
7. Information and communication (new)
8. The monitoring and remediation process (adapted from the monitoring in QC 10)

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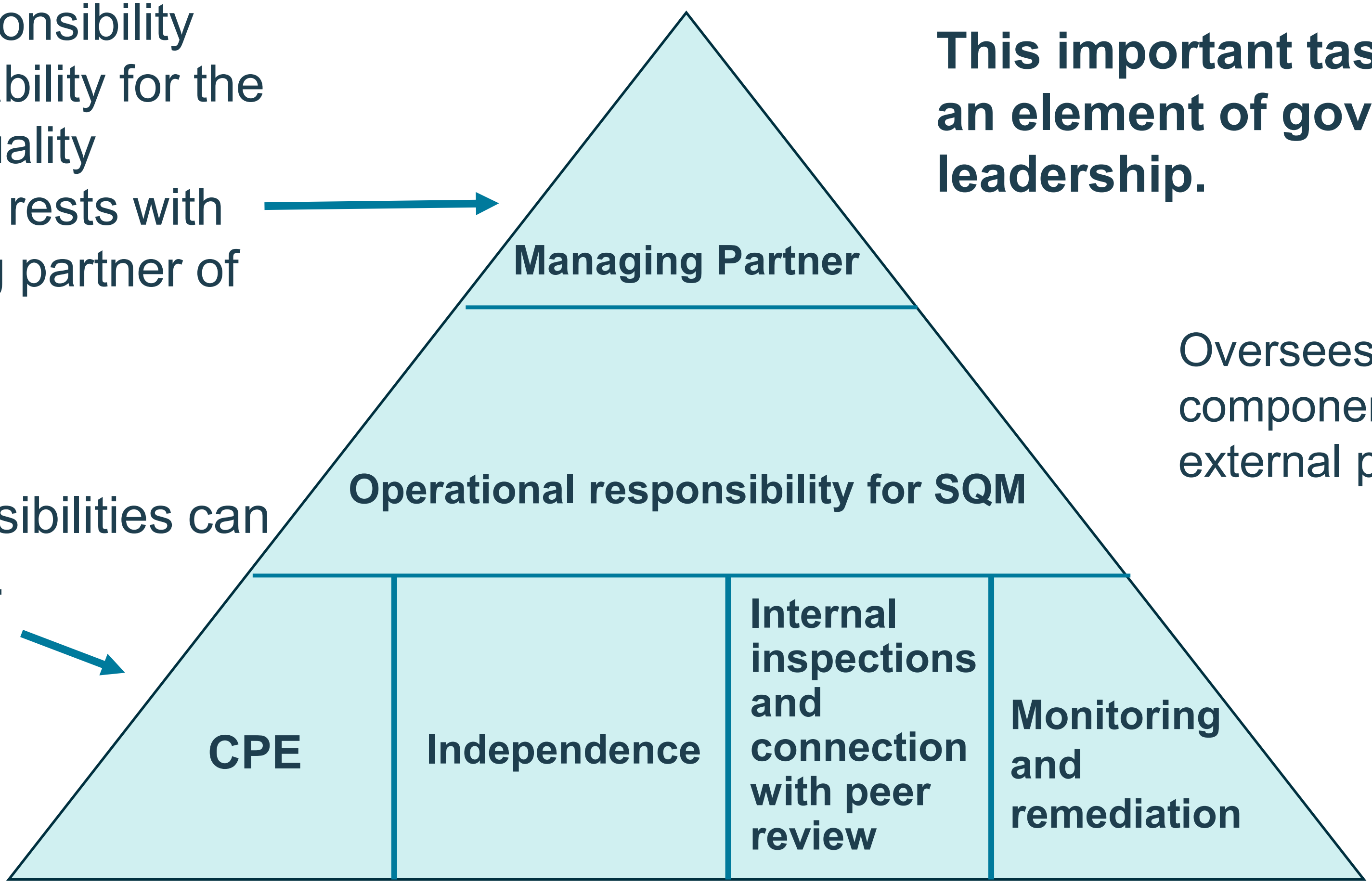
What Is Needed – Assigning Responsibilities

Ultimate responsibility and accountability for the System of Quality Management rests with the managing partner of the firm.

This important task is considered an element of governance and leadership.



Oversees the SQM and delegates components to others, including external parties, as appropriate.

Other responsibilities can be delegated.

An assessment of the SQM will be made on a yearly basis.

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SQMS 1 – Firm's System of Quality Management – Major Changes

- **Component 1: Risk assessment process** – This component is new and is designed to cause firm leadership to assume responsibility for the establishment of quality objectives in each component with the exception of monitoring and remediation
- Firms are also required to establish additional quality objectives when needed based on the nature of the firm and its engagements. The second step to the risk assessment process is to identify risks to the achievement of the objectives (quality risks)
- To do this the firm considers how risks arise and how often they are likely to occur and how long the risk would take to have an effect on quality and whether the firm would, in that period of time, be able to respond and mitigate the quality risk
- Based on the assessment, the firm would initiate a response. The standard specifies certain responses, but these will not be sufficient for the firm to address all of its quality risks

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Component 1: Risk Assessment

- The firm should design and implement a risk assessment process to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks
- The firm should establish the quality objectives specified by this SQMS and any additional quality objectives considered necessary by the firm to achieve the SQM objectives
- The firm should identify and assess quality risks to provide a basis for the design and implementation of responses
- The firm should design and implement responses to address the quality risks in a manner that is based on, and responsive to, the reasons for the assessments given to the quality risks

Identifying Risks to Achieving Quality Management

- Objectives are specifically identified in the standard by category of component of SQM
- Risks are identified in the standard, and the firm should consider its own firm-specific risks
- One approach to identifying objectives would be by category
  - Governance and leadership
  - Relevant ethical requirements
  - Acceptance and continuance
  - Engagement performance
  - Resources
  - Information and communication
  - Monitoring

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How Do I Start?

- Objectives have been identified in the SQMS
- AICPA has identified risks and populated the template. These are generic, and the firm should tailor them
- Practice aid vendors also have templates
- IAASB has issued implementation guidance on their SQMS 1 and 2 equivalents, which might provide additional ideas
  - https://www.iaasb.org/publications/isqm-1-first-time-implementation-guide
  - https://www.ifac.org/flysystem/azure-private/publications/files/IAASB-ISQM-2-first-time-implementation-guide-quality-management.pdf
- Example template (modified AICPA version). Recommend Excel or something similar. This document becomes a road map to tailor the QM document and evaluate the firm's SQM on an ongoing basis

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Component 2: Governance and Leadership Requirements

- Leadership responsible and accountable for quality
- Leadership demonstrates a commitment to quality through actions and behaviors
- Organizational structure and assignment of roles, responsibilities, and authority
- Resource needs – Planning, obtaining, allocating, and assigning
- Organizational structure and assignment of roles and responsibilities and authority

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Component 2: Governance and Leadership Requirements

- Substantial enhancement to the current requirements in QC 10
- The standard recognizes the importance of quality in the firm's strategic decisions and actions
  - Financial and operational priorities
  - Leadership's ability to influence decisions about firm resources
  - Firm's role in serving the public interest
  - Professional ethics, values, and attitudes
  - Responsibility of all personnel
  - Strategic decisions and actions

Component 2: Governance and Leadership Requirements – Objectives

- The firm demonstrates a commitment to quality though its culture
  - Recognizes the firm's role in serving the public interest through performing quality engagements
  - The importance of professional ethics, values, and attitudes
  - The responsibility of all personnel for quality
  - The importance of the firm's strategic decisions and actions
- Leadership is responsible and held accountable for quality
- Leadership demonstrates a commitment to quality through its actions
- The organizational structure and assignment of roles, responsibilities, and authority are appropriate to support achievement of the firm's quality objectives
- Resource needs are planned for, obtained, allocated, or assigned in a manner that reinforces quality

Component 3: Consideration of Relevant Ethical Requirements

- Similar concept as in QC Section 10
- Consider all ethical requirements, with a focus on independence
- Independence rules, generally and in specific areas such as those required for Government Auditing Standards

Component 3: Consideration of Relevant Ethical Requirements

Relevant ethical requirements that the firm's engagements are subject to

ERISA, DOL, OMB, GAGAS

Firm and personnel understand the requirements and fulfill their responsibilities

Others understand the relevant ethical requirements that apply to them and fulfill them

- **Network and firms and individuals in it**
- **Service providers**

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Component 4: Acceptance and Continuance Procedures

- Similar concept as in QC Section 10
- Robust A&C procedures are a hallmark of quality management
- Acceptance and continuance procedures
  - Based on information obtained about the engagement and the integrity and ethical values of the client
  - Reflect the firm's ability to perform the engagement
  - Financial and operational priorities of the firm do not lead to inappropriate judgments
- Scalability of A&C procedures and their documentation
- This component integrates with SAS 146 on Engagement Quality Management

Component 5: Engagement Performance

- Similar concept as in QC Section 10
- Leadership should address engagement performance:
  - Engagement teams understand and fulfill their professional responsibilities
  - Nature, timing, and extent of engagement direction and supervision are appropriate
  - Engagement teams exercise appropriate professional judgment and skepticism
  - Consultation is undertaken, as necessary
  - A process is established for resolving differences of opinion
    - Within the engagement team
    - Between the engagement team and the engagement quality reviewer
    - Between the engagement team and those in the firm's system of quality management
  - Engagement documentation is assembled in a timely basis and in accordance with professional standards

Component 6: Resources

- Significant expansion of concept
  - QC Section 10 addressed only Human Resources
  - SQMS 1 addresses all resources the firm needs to meet its quality objectives

Human Resources

Intellectual Resources

Technology Resources

Governance and Leadership

G&L plans and arranges for resource needs to be met

Resources deals with the actual components

Resources

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Component 6: Resources

- Human Resources objectives
  - Personnel are hired, developed, and retained and have competencies to:
    - Consistently perform quality engagements
    - Perform activities related to the firm's system of quality management
  - Personnel demonstrate a commitment to quality
  - Individuals are sourced from external sources when internal resources are not sufficient
  - Engagement assignments are made to support engagement and firm quality objectives

Component 6: Resources

- The resources component also addresses the following:
  - Technological resources; for example, audit tools or IT applications used by the firm for independence monitoring
  - Intellectual resources; for example, the firm's methodology, guidance, templates, or tools
- The standard also covers the use of resources from service providers, such as methodologies, IT applications, or people used in engagements, and provides guidance to determine that those resources are appropriate for the intended use by the firm

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Component 6: Resources

Technology

- Design, implement, or operate SQM
- Used by engagement teams to perform engagements
- Enable effective operation of IT applications

Intellectual Resources

- Methodology
- Guides
- Checklists
- Access to information/research sources
- Should be consistent with professional standards and applicable legal and regulatory requirements

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Component 6: Resources

Service Providers

- Individual organization external to the firm
- Provides a resource used in the firm's system or engagements
- Excludes anything from within the firm's network
- Includes component auditor from other firms (outside of the firm network)
- Identify the need for additional external resources
- Obtain them from reputable sources
- Develop or obtain appropriate technological resources
- Develop or obtain appropriate intellectual resources

Component 7: Information and Communication Component

- New component
  - The current quality standard, QC 10, does not address the need for information and communication across the system and with engagement teams
  - The ASB feels this is very important to ensure an effective quality management system and effective engagement performance
- SQMS 1 includes a component designed to provide guidance on this two-way mechanism to supply a continuous flow of information and communication
- The standard requires the firm to implement an information system that contains processes to identify, capture, process, and maintain information
- The standard is scalable, acknowledging that less-complex firms with fewer personnel and direct involvement of leadership may accomplish the objective with less rigorous or detailed policies and procedures
- The standard addresses both internal and external communication

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Component 7: Information and Communication Component

Information System
- Software used for training materials
- Software used to identify compliance
- Other QM software

Culture, Responsibility to Communicate
- Within the engagement team
- Within the firm
- As part of a firm network

THE FIRM

Within the firm:
- Personnel as part of an engagement team
- Related to EQR
- Related to performing and communicating information on monitoring and remediation
- Related to identifying risks

Exchange information throughout the firm
- Within the engagement team
- Within the firm in general

Communication to external parties
- When required by law or regulation and when needed for the SQM
- Communication to governance in an engagement
- Specified responses in SQM

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Component 7: Information and Communication Component

- Objectives should address the following
  - Obtaining, generating, or using information regarding the system of quality management
  - Communicating such information on a timely basis to those within the firm and to external parties
- Considerations of the information and communication objective
  - The information system identifies, captures, processes, and maintains relevant and reliable information
  - The culture of the firm recognizes and reinforces the responsibility of personnel to effectively exchange information
  - Relevant and reliable information is exchanged throughout the firm, network, and service providers

Component 8: Monitoring and Remediation

- Proactive monitoring to provide a better basis for management to evaluate the system of quality management
  - SQCS 8 focused on engagement level monitoring
  - SQMS 1 focuses on monitoring activities broadening the focus to the entire system of quality management
- Objectives of the monitoring and remediation process:
  - Provide relevant, reliable, and timely information about the design, implementation, and operation of the firm's quality management system
  - Allows the firm to take appropriate actions to respond to identified deficiencies such that they are remediated on a timely basis

Component 8: Monitoring and Remediation

Considerations in designing monitoring activities:

1. The reasons for the assessments given to quality risk
2. The design of the responses
3. The design of the firm's risk assessment, monitoring, and remediation processes
4. Changes to the firm's system of quality management
5. Results of previous monitoring activities
6. Other relevant information

Also consider size, structure, organization of firm, involvement of network, and resources to be used

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Component 8: Monitoring and Remediation

Design and perform monitoring procedures

1. Evaluate findings
2. Identify deficiencies
3. Evaluate identified deficiencies

Respond to deficiencies

Communicate

- Iterative process
- Integrated with other SQM Components
- Person with responsibility for this process must have resources (competence, capabilities, and objectivity)

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Component 8: Monitoring and Remediation

- A peer review is not a substitute for all monitoring activities
- Peer review may be a substitute for the inspection of engagement documentation, reports, and clients' financial statements for some or all engagements for the period covered by the peer review
- Peer review definitions of findings and deficiencies are not the same as SQMS 1
- Findings or deficiencies identified in a firm's system of quality management may not necessarily result in a peer review finding or deficiency
- Firm should assess any peer review findings or deficiencies to determine the impact on the firm's evaluation of its system of quality management

Component 8: Monitoring and Remediation

- SQMS 1 does not preclude an individual from performing monitoring activities, including inspections of their own compliance with a quality management system
- Self-inspections may be less effective than compliance inspections by another qualified individual
- With self-inspections the firm has a higher risk that noncompliance with policies and procedures will not be detected or reported
- Responses that may provide safeguards against the self-review include:
  - Fostering a commitment to continuing professional education and providing effective training programs so that personnel stay current on accounting, auditing, and quality management standards
  - Providing training on how to perform monitoring inspections and requiring the use of peer review or other inspection checklists
  - Requiring the passage of time after the completion of an engagement before self inspections are performed

Component 8: Monitoring and Remediation

Findings

- Issues coming to light during monitoring activities, external inspections, or other sources related to the design, implementation, and operation of the SQM that indicates that deficiencies may exist

Evaluate findings to determine whether deficiencies exist

- Use professional judgement
- Consider the design of the response and extent to which a quality risk is not addressed
- Pervasiveness
- If finding indicates a systemic issue
- Extent of the finding

Deficiencies

- Important quality objective **is not established**
- Quality risk **is not identified or properly addressed**
- Improper design, implementation or operation of response
- Another aspect of SQM is absent or not properly designed and implemented

Evaluate deficiencies

- Consider severity and pervasiveness using professional judgment
- Investigate the root cause
- Evaluate the effect of the deficiencies, individually and aggregate on the SQM

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Component 8: Monitoring and Remediation

Design and implement remedial actions

- Responsive to root cause
- Also respond if findings on engagements indicate omitted procedures or inappropriate report or other issues (e.g., disclosures)

Evaluate remedial actions

- Have the actions been implemented?
- Are the actions implemented for previous deficiencies effective?

Take action if remediation doesn’t work

- Identify other actions that can be used to resolve the issue

Communicate

- Communicate findings and deficiencies to individuals or to the practice as appropriate

SQMS 2 – Engagement Quality Review

Engagement Quality Review – SQMS 2

- SQMS 1 integrates with SQMS 2
- The firm establishes policies or procedures that address engagement quality reviews in accordance with SQMS No. 2
- The firm may decide there are no engagements that need EQR

SQMS 2 – Engagement Quality Review

Engagement Quality Review – SQMS 2

- The firm should establish policies or procedures that address the criteria for eligibility to be appointed an engagement quality reviewer
- Policies or procedures should require that the engagement quality reviewer:
  - Not be a member of the engagement team
  - Have the competence and capabilities, including sufficient time, and the appropriate authority to perform the engagement quality review
  - Comply with relevant ethical requirements, including those addressing threats to the objectivity and independence of the engagement quality reviewer
  - Comply with provisions of law and regulation, if any, that are relevant to the eligibility of the engagement quality reviewer

- **Discussion questions**
  - Which of the components of the new Quality Management Standards that you implemented as of December 2025 were the hardest to implement?
  - Which do you think will be the most difficult to maintain going forward?

Key Definitions Related to SSARS Engagements Found in AR-C Section 60

- Applicable financial reporting framework
- Designated accounting standard setter
- Fair presentation framework
- General purpose financial statements
- Special purpose financial statements

Requirements of AR-C Section 60

- Accountant on a SSARS engagement must comply with all relevant ethical requirements:
  - AICPA Code of Conduct
    - Accountant's responsibilities
    - The public interest
    - Integrity
    - Objectivity and independence
    - Due care
    - Scope and nature of services
  - Must also address State Board and regulatory requirements

Key Elements of AR-C Section 60

- Use of professional judgment
- Conducting engagement in accordance with SSARS
  - Unconditional and presumptively mandatory procedures
  - Documentation of departures
- Appropriate engagement level quality management
  - Responsibilities of the partner
  - Composition of engagement team
- Appropriate client and engagement acceptance and continuance procedures

Other Sources for Guidance on SSARS Engagements

- Accountants should consult other applicable guidance to assist with the performance of SSARS engagements
  - AICPA guides such as its *Preparation, Compilation, and Review Engagements Guide*
  - AICPA annual alert addressing engagements performed in accordance with the SSARS
  - 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; guidebooks; programs for preparation, compilation, and review engagements
  - Checklists
  - Other publications addressing preparation, compilation, and review engagements for state CPA societies, other organizations, and individuals

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Accepting Preparation, Compilation, and Review Engagements

- Two basic sets of procedures:
  1. Evaluation of engagement:
     - Overall procedures in place to consider matters such as QM standards and independence
     - Appropriateness of financial reporting framework
  2. Related to prospective client:
     - Client integrity, services to be performed, intended users of F/Ss

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Considerations Related to the Appropriateness of the Financial Reporting Framework

- Applicable frameworks are either general purpose or special purpose
- Relevant factors in assessing the financial reporting framework selected by management
  - The nature of the entity (for example, whether it is a business enterprise, a governmental entity, or a not-for-profit organization)
  - The purpose of the financial statements (for example, whether they are prepared to meet the common financial information needs of a wide range of users)
  - The nature of the financial statements (for example, whether the financial statements are a complete set of financial statements or a single financial statement)
  - Whether law or regulation prescribes the applicable financial reporting
- Financial statements and selection of the appropriate framework are the responsibility of management
  - Such responsibility should be acknowledged in the engagement letter
  - Accountant may rely on the information provided by management

CCC – It All Begins With Quality Management

- **Competence** to perform the engagement
- **Compliance** with legal and relevant ethical requirements
- **Consideration** of client integrity

Competence

- Competence – Ability to perform job properly
- Ability to perform compilation or review according to the standards based on your professional knowledge, skills, and experience

Compliance With Legal and Relevant Ethical Requirements

- Understand and be comfortable with any regulatory or reporting requirements involved in engagement
- Comply with relevant ethical requirements:
  - AICPA *Code of Professional Conduct*
  - The Independence Rule
  - State Board of Accountancy rules
  - Applicable regulatory agencies

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Consideration of Client Integrity

- ***Who*** owner is, reputation, criminal activity (Tony Soprano?)
- ***What*** business in and its business practices
- ***Why*** business is hiring you
- Talk with other CPAs, lawyers, consultants who currently or previously provided professional services to client:
  - In accordance with relevant ethical requirements
- Conduct background searches on client, its management, and business operations

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Client Acceptance Process

- Interview prospective client
- Assess client’s commitment to appropriate application of applicable financial reporting framework
- Assess client’s commitment to implementing and maintaining effective internal control
- Assess client’s financial viability
- Communicate with predecessor accountant
- Review your independence and objectivity
- Consider other issues

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Documentation

- Whether or not you decide to accept or reject a new client:
  - Properly document engagement acceptance process and retain according to your policies and procedures

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Client Engagement Acceptance Forms

- Basic engagement information:
  - Entity's legal name, description, primary contacts, type of operations, management structure, services to be provided
- Any communications with predecessor accountants
- Client relationship matters – Integrity, conflicts of interest
- Client acceptance procedures discussed above

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Chapter 4

AR-C 70: Performing Financial Statement Preparation Services

Chapter Learning Objectives

- After completing this chapter, you should be familiar with:
  - The requirements of AR-C section 70, *Preparation of Financial Statements*;
  - How to perform preparation of financial statement engagements; and
  - SSARS No. 27, *Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services Engagement* (April 2025; effective for periods ending on or after December 15, 2026. Early implementation is permitted)

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Key Provisions of AR-C Section 70

- Key provisions of AR-C section 70:
  - Objective is to prepare financial statements in accordance with financial reporting framework selected by management
  - Established preparation of financial statements as a nonattest service
  - Can be applied or adapted to other historical or prospective financial information
  - Requires a signed engagement letter
  - Service is different from bookkeeping services that aren’t covered by AR-C section 70

Preparation of F/S – When AR-C Section 70 Applies

- Preparation of F/S prior for audit or review by another accountant
- Preparation of F/S presented alongside tax return
- Preparation of single F/S with substantially all disclosures omitted
- Using information in G/L to prepare F/S <u>outside</u> of an accounting software system

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Preparation of F/S – When AR-C Section 70 Does NOT Apply

- Preparing F/S when also engaged to perform attest services on those F/S
- Preparing tax returns or other data solely for submission to taxing authorities
- Personal F/S prepared for inclusion in written personal financial plans prepared by the accountant
- F/S prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
- F/S prepared in conjunction with business valuation services (VS section 100) – Note that SSARS No. 27 amends this carve-out effective for periods ending on or after December 15, 2026

Preparation of F/S – When AR-C Section 70 Does NOT Apply

- Maintaining depreciation schedules
- Preparing or proposing certain adjustments, such as deferred income taxes, depreciation, or leases
- Drafting F/S notes
- Entering G/L transactions into accounting software system

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Key Elements of an AR-C Section 70 Engagement

- Nonattest service – No report
- No evaluation of independence requirement
- Must determine that scope isn't bookkeeping:
  - Bookkeeping services not addressed by SSARS
  - See AR-C section 70 appendix for further guidance

Accountant’s Responsibilities

- **Do I have to verify accuracy or completeness?**
  - Not required to verify the accuracy or completeness of the information provided by management
  - Not required to gather evidence to express an opinion or a conclusion on the F/S or otherwise report on the F/S
  - Uses the records, documents, explanations, and other information provided by management

CPA Performing Controllership or Other Management Services

- If meeting <u>all</u> of the following criteria, comply with SSARS, as applicable:
  1. Practices public accounting
  2. Provides services that involve preparation of F/S as part of terms of engagement
  3. Not a stockholder, partner, director, officer, or employee of entity

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CPA Preparing F/S as Part of Entity Responsibilities

- If accountant in public practice prepares F/S and is also a stockholder, partner, director, officer, or employee of entity may:
  - Comply with SSARS, or
  - The accompanying balance sheet of ABC Company as of December 31. 20XX, and the related statements of income and cash flows for the year then ended have been prepared by NAME, CPA. I have prepared such financial statements in my capacity DESCRIBE of ABC Company
- Matter of professional judgment:
  - Manage risk of litigation

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SSARS No. 21 – *Preparation of F/S* – Minimum Requirements

- Signed engagement letter with required minimum elements
- Understanding of the applicable financial reporting framework and significant accounting policies intended to be used:
  - Describe use of a special purpose framework on face of F/S or notes
- Prepare the F/S with necessary disclosure that no assurance provided

SSARS No. 21 – *Preparation of F/S* – Statement of Lack of Assurance

- Management must acknowledge and understand its responsibility to include a statement on each page of the F/S indicating that no assurance is provided on the F/S:
  - Statement is made at management's discretion and accountant's firm name is not required to be included
- Management should include a statement on each page of the F/S at a minimum indicating that "no assurance is provided"

Example Lack of Assurance Statements

- Examples of management-provided statement of no assurance:
  - These financial statements have not been subjected to an audit or review or compilation engagement, and no assurance is provided on them
  - No assurance is provided on these financial statements

SSARS No. 21 – *Preparation of F/S* – Statement of Lack of Assurance

- If management is unable to include a statement on each page, the accountant should EITHER:
  - Issue a disclaimer that makes clear that no assurance is provided
  - Perform a compilation, review, or audit engagement
  - Withdrawal, after notifying the client as to the reason

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Example Accountant Disclaimer to Management

- Example of accountant-provided disclaimer to management:
  - The accompanying financial statements of XYZ Company as of and for the year ended December 31, 20XX, were not subjected to an audit, review, or compilation engagement by me (us) and, accordingly, I (we) do not express an opinion, a conclusion, nor provide any assurance on them
  - Signature, date, and city/state

Prescribed Form Engagements

- Forms that are prescribed, or the related instructions, may call for departures from requirements in the applicable financial reporting framework:
  - E.g., specifies measurement principles not in accordance with applicable framework, or failure to request certain disclosures or presentation typically required
  - Any standard preprinted form designed or adopted by the body to which it is to be transmitted, so presumed to meet their needs and a modified report is not necessary

Prescribed Form Engagements

- Prescribed form statements may need to be prepared in accordance with a special purpose framework
- AR-C section 70 allows for preparation of prescribed form financial statements

SSARS No. 21 – *Preparation of F/S* – Minimum Requirements

- Discuss any significant judgments applied with management, ensuring management accepts responsibility
- If F/S are deemed incomplete, inaccurate, or otherwise unsatisfactory – request additional or corrected information from management:
  - Disclose any known material departures in the F/S on face or in notes
- Preparation of PFI engagements should have a summary of significant assumptions

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SSARS No. 21 – *Preparation of F/S* – Additional Requirements

- Omitting substantially all disclosures:
  - Disclose omission in the F/S
  - Do not accept engagement if the financial statements would be misleading (i.e., going concern)
    - Judgment is required
  - If few matters disclosed, label as “Selected Information – Substantially All Disclosures Required by (name framework) Are Not Included”

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SSARS No. 27 – Key Updates to AR-C 70

- Clarified that AR-C 70 is not required (though not precluded) when financial statements are prepared: (a) as part of a consulting services engagement under CS section 100 where preparation is not the primary objective; (b) as part of a personal financial plan under PFP section 100; (c) as part of a business valuation under VS section 100; (d) solely for submission to taxing authorities; or (e) in conjunction with litigation services
- New paragraph .A4: Accountants may voluntarily apply AR-C 70 even when not required (e.g., including the “no assurance” statement to prevent user misunderstanding)

Going Concern – AR-C Section 70 – Preparation of F/S

- Nonattest service that does not require a report
- May omit substantially all disclosures (including going concern substantial doubt) if disclosed by the accountant on the face of the F/S
- If there are known departures from the applicable financial reporting framework (including inadequate disclosures), the accountant should disclose the material misstatement(s) in the F/S
- Do not undertake engagement if omission of <u>any</u> disclosures would mislead F/S users

SSARS No. 21 – *Preparation of F/S* – Additional Requirements

- Documentation should be sufficient to provide clear understanding of the work performed:
  - Signed engagement letter or suitable written agreement
  - Copy of prepared F/S

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Impact of SSARS No. 21 on Peer Review

- AICPA *Standards for Performing and Reporting on Peer Reviews*:
  - Include section 70 engagements within scope of peer review and definition of an accounting and auditing practice
  - Firms that only perform section 70 engagements are NOT <u>required</u> to enroll in Peer Review Program, but may do so

Applying What You've Learned

Discussion Question:

What challenges have you faced in determining whether your engagements are covered by the SSARS or not?

Applying What You've Learned

Practice Exercise

Exercise 1 – Determine if AR-C section 70 applies

Chapter 5

AR-C 80: Performing and Reporting on Compilation Engagements

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Chapter Learning Objectives

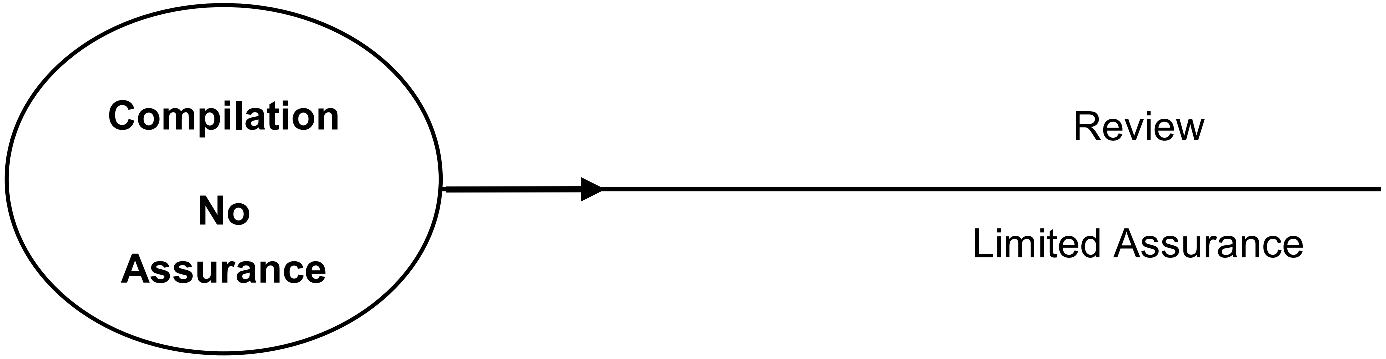
- After completing this chapter, you should be familiar with:
  - Performing and reporting on compilation engagements; and
  - The impact of SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services*, on compilation engagements (effective for periods beginning on or after December 15, 2025)

Compiling Financial Statements

- Simplest of financial statement engagements to perform and report on
- Engaged to assist management in presenting information in form of financial statements
- Not an assurance engagement – So no assurance procedures
- Accountant is not required to be independent
  - Must disclose in report if not independent
  - Must follow the rest of the Code provisions
- Not required to understand internal control or actively search for fraud and illegal acts

Compilation Engagements

- Significantly different than review engagements – Both performance requirements and reporting



- Authoritative guidance – AR-C section 80, *Compilation Engagements*

Compilation Engagements

- No assurance that there are no material modifications that should be made to the F/S in order for them to comply with the applicable financial reporting framework:
  - Does not contemplate inquiry, analytical procedures, or other procedures

Preparation of Financial Statements vs. Compilation of Financial Statements

	Preparation	Compilation
When does the standard apply?	When an accountant is engaged to prepare financial statements.	When an accountant is engaged to perform a compilation.
Is an engagement letter required?	Yes	Yes
Is the accountant required to determine if he or she is independent of the client?	No	Yes
If the accountant is not independent, is that fact required to be disclosed?	N/A	Yes
Does the engagement require a report?	No	Yes
May the financial statements go to users outside of management?	Yes	Yes
May the financial statements omit notes?	Yes	Yes

Acceptance and Continuance

- Apply the guidance in AR-C section 60 paragraphs .30–.31, and
- Guidance in AR-C section 80, paragraph .08:
  - Management's responsibility for financial statements
  - Required disclosures for financial statements using special purpose framework
  - Management agrees to include compilation report in any document containing financial statements
- Accountant should not accept the engagement if the above understandings are not obtained

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Components of Signed Engagement Letter

- Signed engagement letter required by AR-C section 80
  - Best practice to obtain annually
  - Can be combined with that for other services
- The following should be included in the letter:
  - Engagement objectives
  - Management and accountant's responsibilities
  - Limitations of compilation engagement
  - Identification of financial reporting framework
  - Expected form and content of accountant's report

See example engagement letter in course materials

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Performing a Compilation Engagement Under AR-C Section 80

- Accountant not required to verify completeness and accuracy of information received from management
- No requirement to perform in-depth procedures
- Accountant must understand the industry:
  - Accounting principles used in that industry
  - How the business is organized and operates
  - Understand nature of assets, liabilities, revenues, and expenses
- Other procedures to comply with AR-C section 80

Understanding the Entity and Its Business

- **Industry:**
  - Accounting principles and practices generally used – Allows compilation of proper financial statements common to particular industry
- **Client's business:**
  - How organized and operates, nature of assets, liabilities, revenues, and expenses – Generally get by working directly with client or similar clients in same industry
- **Accounting principles and practices used by client:**
  - Helps to recognize any unusual accounting practices using relative to industry norms

Compilation Procedures – "RRP"

- Understand entity's financial reporting framework:
  - Not necessary at date of acceptance
- Read the financial statements
- Request additional or corrected information, as needed
- Propose any appropriate revisions

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"Final Read"

- F/Ss conform with financial reporting framework used
- No obvious errors:
  - Typos, math, application of accounting principles, inadequate disclosures
- Objective:
  - To make sure you do not associate yourself with misleading financial statements (which is an ethics violation)
- If you conclude F/Ss are misleading:
  - Withdraw from engagement

On compilation of pro forma financial information engagements performed under AR-C 120, these procedures should be followed as well

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Accountant Should Assure the Following About the Financial Statements

- Describe the financial reporting framework used
- Assure financial statements are not misleading:
  - I.e., Financial statements prepared on a going concern basis, but uncertainty exists about this assertion
  - Another departure from requirements of financial reporting framework
  - Disclosures not required if substantially all disclosures omitted
- Accountant should consider withdrawing when:
  - Management has not provided materials necessary to complete engagement
  - Management doesn't make appropriate revisions, and accountant doesn't disclose departures in report

AR-C Section 80 – Required Minimum and Suggested Other Documentation

- Signed engagement letter
- Copy of the financial statements and the accountant's report
- Though not required, consider including the following:
  - A checklist documenting knowledge of client and industry
  - Support for data in footnotes and reason for omission, if applicable
  - A discussion of significant unusual matters encountered
  - Documentation that the CPA read the compiled financial statements
  - The reasons for omissions of all, or substantially all, disclosures
  - A description of any related accounting or bookkeeping services performed
  - The reasons for a step-down from an audit or review, if applicable

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Management Representations Letter

- **Not Required** – Best practice
- Specific representations:
  - Matter of professional judgment
  - Depend on particular engagement circumstances
  - Should include any representations made to you, explicitly or implicitly, during engagement
- Example management representations letter

Please See Example in Text

Reporting Considerations for Compilation Engagements

SSARS No. 21 – Compilation Reporting Considerations

- Standard report is a single paragraph description of management and accountant responsibilities, including lack of any assurance:
  - Include city and state where the accountant practices
  - Accountant's signature and date

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Compilation Report

Management is responsible for the accompanying financial statements of XYZ Company, which comprise the balance sheets as of December 31, 20X5 and 20X4 and the related statements of income, changes in stockholder's equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. I (we) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (we) did not audit or review the financial statements nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. I (we) do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.

[*Signature of accountant or accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

Considerations When Reporting on PFI

- The accountant should not issue a compilation report on PFI that excludes a summary of significant assumptions
- The report on PFI should include the following statements:
  - The forecasted or projected results may not be achieved
  - The accountant has no responsibility to update the report for events and circumstances that occur after the report date

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Other Matter Paragraph Examples

- Lack of independence
- Use of a special purpose framework in lieu of GAAP
- Management’s election to substantially omit all disclosures
- Accountant is aware of departure from applicable framework
- Degree of responsibility for supplementary information, including any required supplementary information

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Reporting When the Accountant Is Not Independent

- Accountant must assess independence, but there is no requirement to be independent
- Add the following last paragraph to the report:
  - "I am not independent with respect to entity's XYZ Company"
- Accountant can elect to disclose reason for lack of independence:
  - Must disclose all reasons for lack of independence
  - See AR-C section 80, Exhibit B for sample wording
- If multiple reasons exist, all must be disclosed. For example:
  - "I am not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I had a direct financial interest in XYZ Company, and I performed certain accounting services that impaired my independence"

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Reporting When Financial Statements Use a Special Purpose Framework

- Titles of financial statements should be modified to include name of framework, but captions may be the same:
  - I.e., Balance Sheet – Income tax basis
  - I.e., Cash, accounts receivable
- Additional paragraph in report
- Required policy note that describes difference with U.S. GAAP
- Differences do not need to be quantified
- Other disclosures should parallel U.S. GAAP, if framework doesn't specify
- Accountant should modify report if above aren't present:
  - Unless entity decided to omit substantially all disclosures

Other Considerations Related to Use of Special Purpose Frameworks

- Contractual basis financial statements
  - Alteration of compilation report when financial statements don't adequately describe significant interpretations of the contract
  - If contractual basis for the financial statements is general purpose framework but they don't comply with it, noncompliance is a known departure
- Update report language when management has a choice of special purpose framework to reflect management's responsibilities
- For contractual basis financial statements, the report should include a separate paragraph that states that the financial statements may not be suitable for another purpose

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Compilation Report – Special Purpose Framework

Management is responsible for the accompanying financial statements of XYZ Company … in accordance with the tax-basis of accounting.

[Continued same language as non-SPF report]

I (we) draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the tax-basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America.

[*Signature of accountant accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

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Other Reporting Considerations

- Accountant may issue a report on one financial statement
- Going concern uncertainty
  - Must follow the reporting and disclosure requirements of framework
  - If management omits disclosures, can’t mislead users
- Report dating – Use the date of the completion of the compilation
- General vs. restricted use
  - Separate paragraph for restricted use
  - Restrict use for the following:
    - Measurement criteria is contained in a contractual agreement
    - Regulatory provisions not in accordance with GAAP or SPF
- May use prescribed forms but may be considered an SPF

Omitting Substantially All Disclosures

- May omit statements of cash flow or other comprehensive income, unless full-disclosure F/S
- May <u>not</u> omit if omission would mislead users
- Must add paragraph in standard report
- Mark any notes presented:
  - Selected Information – *Substantially All Disclosures Required By Generally Accepted Accounting Principles Are Not Included*
  - GAAP departure if more than a few notes presented

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Compilation Report – Omitting Substantially All Disclosures

Management is responsible for the accompanying financial statements of XYZ Company … in accordance with the tax-basis of accounting.

[Continued same language as non-SPF report]

Management has elected to omit substantially all of the disclosures required by the tax-basis of accounting. If the omitted disclosures were included in the financial statements, they may influence the user's conclusions about the company's financial position, results of operations, and cash flows. Accordingly, the financial statements are not designed for those who are not informed about such matters.

[*Signature of accountant accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

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What If F/S Are Misleading?

- For example, material measurement or disclosure departures
- Obtain sufficient relevant data to afford reasonable basis for conclusions
- If client refuses to provide additional or revised information, either:
  - Alter report (e.g., GAAP departure); or
  - Withdraw from the engagement if report modification not deemed adequate to draw attention to financial statement deficiency

Common GAAP Departures

- Nonconsolidation of appropriate subsidiaries
- Omission of significant income tax provisions
- Omission of significant disclosures related to material defined employee-benefit plans
- Improper capitalization of start-up expenses
- Recording a capital lease as an operating lease
- Omission of compensated absences
- Missing required significant accounting policy notes

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Compilation Report – Departure From Financial Reporting Framework

Management is responsible for the accompanying financial statements of XYZ Company … in accordance with accounting principles generally accepted in the United States of America.

[Continued same language as non-SPF report]

Accounting principles generally accepted in the United States of America require that land be stated at cost. Management has informed me (us) the XYZ Company has stated its land at appraised value and that if accounting principles in the United States of America had been followed, the land account and stockholders' equity would have been decreased by $500,000.

[*Signature of accountant accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

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Supplementary Information

- Updates made to report by SSARS No. 23:
  - Definition of supplementary information
  - May be prepared in accordance with reporting framework or another framework
- Accountant should clearly indicate degree of responsibility, if any
- May refer to other data in compilation report
- May issue separate report on compilation of other data:
  - Other data accompanying F/S presented only for additional analysis
  - Information is a representation of management, without audit or review
  - Accountant does not express opinion or provide assurance

SSARS No. 23 Compilation Report – Accountant Compiled Supplementary Information

Management is responsible for the accompanying financial statements of XYZ Company … in accordance with accounting principles generally accepted in the United States of America.

[Continued same language as non-SPF report]

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was subject to our compilation engagement. I (We) have not audited or reviewed the supplementary information and, accordingly, do not express an opinion, a conclusion, or provide any assurance on such information.

[*Signature of accountant accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

SSARS No. 23 Compilation Report – Accountant Did Not Compile Supplementary Information

Management is responsible for the accompanying financial statements of XYZ Company … in accordance with accounting principles generally accepted in the United States of America

[Continued same language as non-SPF report]

The accompanying supplementary information is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information is the responsibility of management. The supplementary information was not subject to our compilation. I (We) do not express an opinion, a conclusion, or provide any assurance on such information.

[*Signature of accountant accounting firm, as appropriate*]

[*City and state where the accountant practices*]

[*Date of the accountant's report*]

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Required Supplementary Information (RSI)

- Required by designated standard-setting body:
  - Common interest realty associations – Estimate of future major repairs and replacements of common property
  - GASB MD&A and Budgetary Comparison
- Accountant not required to perform procedures, but may be engaged to compile, review, or audit:
  - Include other matter paragraph relating to accountant's responsibility
  - Distinct from paragraph discussing any omission of RSI in a compilation from other disclosures substantially omitted

RSI – Other Matter Paragraph Scenarios

- RSI is included, and accountant compiled it
- RSI is included, and accountant did not attest on it
- The RSI is omitted
- Some RSI is missing, and some presented in accordance with prescribed guidelines
- Identified departures from the prescribed guidelines
- Unresolved doubts about whether the RSI is presented in accordance with prescribed guidelines

Restricted Use Report

- Intended for one or more specified third parties
- Includes a separate paragraph stating intended specified parties:
  - Report not intended to be used and should not be used by anyone other than the specified parties
- Subject matter that requires report restriction:
  - Measurement or disclosure criteria contained in contractual agreements
  - Regulatory provisions that are not in conformity with the applicable financial reporting framework

Going Concern: AR-C Section 80 – *Compilation Engagements*

- Financial statements may omit substantially all disclosures (including going concern substantial doubt):
  - *Such omissions should be disclosed in the financial statements and an* additional paragraph added in the standard report
- If known departures – including inadequate disclosures – disclose the material misstatement(s):
  - Modify the report to disclose <u>any</u> material departures if departure itself is <u>not</u> disclosed in the financial statements
  - Withdraw if report modification is not deemed adequate (e.g., omission of <u>any</u> disclosures are undertaken with intention of misleading financial statement users)

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Peer Review Issue #1 – Compilation Engagements: Failure To Prepare Reports in Accordance With Professional Standards

General Reporting and Disclosure Issues:

1. Significant departures from the financial statement formats prescribed by industry accounting and audit guides
2. Omission of disclosures related to significant accounting policies applied (whether GAAP or special purpose framework)
3. Failure to include a summary of significant assumptions in a financial forecast or projection
4. Failure to segregate the statement of cash flows into components: operating, investing, and financing activities. Failure to consider all noncash financing and investing activities
5. Failure to disclose the cumulative effect of a change in accounting principle
6. Failure to disclose significant related party transactions
7. Omission of financial statements that are noted in the report
8. Failure to include one or more statements of cash flows when comparative results of operations are presented in accordance with GAAP

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Peer Review Issue #1 – Compilation Engagements: Failure To Prepare Reports in Accordance With Professional Standards

Preparation Engagements

1. Failure to include, either on the face of the financial statements, or in a note, a description of the financial reporting framework when the statements have been prepared in accordance with a special purpose framework
2. Failure to disclose a material misstatement in the financial statements when the accountant prepares financial statements that contain a known departure from the applicable financial reporting framework

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Peer Review Issue #1 – Compilation Engagements: Failure To Prepare Reports in Accordance With Professional Standards

Compilation Engagements

1. Accountants disclosed that substantially all of the disclosures were omitted when that was not the case. In some cases, this is a matter of choosing the incorrect report form. It is appropriate to prepare a compilation report without disclosures
2. Sometimes certain disclosures are missing when substantially all other disclosures are presented. This should be treated in a compilation report like any other departure from the applicable financial reporting framework, and the nature of the departure and its effects, if known, should be disclosed
3. Failure to disclose that compiled financial statements that omit substantially all disclosures were prepared using a special purpose framework and the basis of accounting is not readily determinable from reading the accountant's compilation report
4. Reports do not contain the required elements. This may be because the language was not updated for the current language in the SSARS

Peer Review Issue #1 – Compilation Engagements: Failure To Prepare Reports in Accordance With Professional Standards

Compilation Engagements (cont.)

5. Reports do not always specify the date or period covered by the financial statements
6. Reports do not always include a separate paragraph when supplementary information accompanies financial statements. Note that accountants can always issue a separate report on the supplementary information
7. Reports do not always include a separate paragraph in the accountant's compilation report that includes the required elements when reporting on financial statements that omit substantially all disclosures required by the applicable financial reporting framework
8. Lack of independence is not always cited when this is the case

Peer Review Issue #2 – Compilation Engagements: Failure To Document the Agreed-Upon Terms of the Engagement

- Peer reviewers have noted that accountants often fail to:
  - Use the updated SSARS language
  - Identify lack of independence
  - Include the expected form and content of the accountant's compilation
  - Report when the accountant's independence is impaired. Lack of independence is permissible if disclosed in the report
  - Identify the applicable financial reporting framework for the preparation of the financial statements
  - Engagement letters are now required for all levels of service

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Chapter 6

AR-C 90: Performing and Reporting on Review Engagements

Chapter Learning Objectives

- After completing this chapter, you should be familiar with:
  - Performing and reporting on review engagements; and
  - The engagement-level quality management requirements of SSARS No. 26, *Quality Management for an Engagement Conducted in Accordance with Statements on Standards for Accounting and Review Services*, and their application to review engagements

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AR-C Section 90: Performing and Reporting on Review Engagements

- AR-C section 90 addresses the accountant's responsibilities when engaged to review financial statements
  - This section may also be applied, as necessary in the circumstances, to engagements to review other historical financial information
- Generally, SSARS No. 21 did not make significant changes to the guidance on performing review engagements but rather clarified the guidance previously found in SSARS No. 19
  - SSARS No. 23, SSARS No. 24, SSARS No. 25, and SSARS No. 26 all amended or clarified AR-C section 90. These updates to the guidance will also be discussed in the following sections
- AR-C section 90 does **not** apply when reviewing interim financial information if all three conditions are met:
  - The entity's latest annual financial statements have been audited by the accountant or a predecessor;
  - The accountant is engaged to audit the current year's financial statements (or audited the latest annual financial statements where current year audit is expected); and
  - The entity prepares its interim financial information using the same financial reporting framework as its annual statements
- In those cases, AU-C section 930, Interim Financial Information, provides the applicable guidance

AR-C Section 90: Performing and Reporting on Review Engagements

- SSARS No. 21 did make fairly significant changes to when the accountant should add an additional paragraph to the standard review conclusion in order to emphasize items such as use of a special purpose financial reporting framework or a change in framework used
- SSARS No. 21 also encourages the use of an emphasis-of-matter paragraph to address other situations that arose over the course of the review

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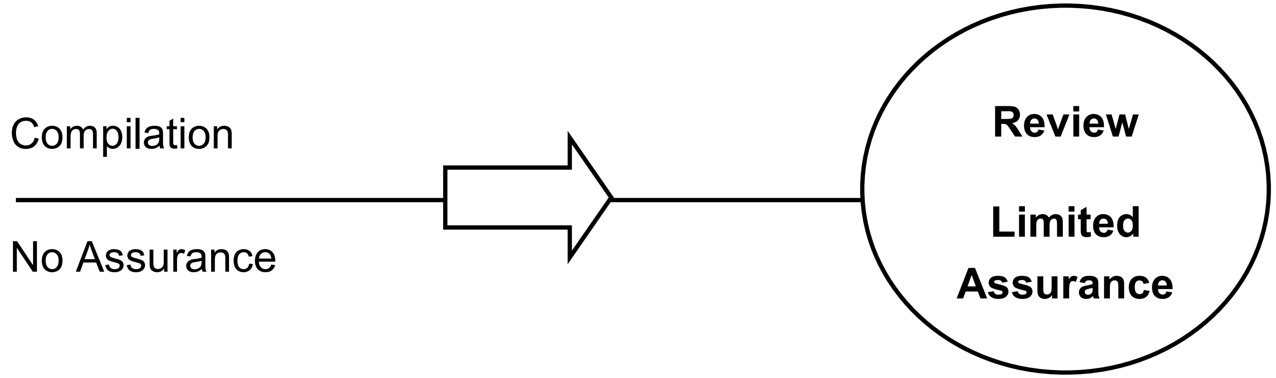
Review Engagements

- Significantly different than compilation engagements
- Assurance engagement – “Limited” assurance that F/Ss are not materially misstated



- Authoritative guidance – AR-C section 90, *Review of Financial Statements*

Objective of a Review

- The accountant expresses a conclusion regarding the entity's financial statements in accordance with an applicable financial reporting framework
  - Limited assurance that there are no material modifications necessary to financial statements, including disclosures, to be in conformity with an applicable financial reporting framework
  - The accountant's report includes a description of the nature of a review engagement as context for the readers of the report to be able to understand the conclusion
- Independence is required, and can't be disclaimed

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Performing a Review Engagement

- A review is an assurance engagement
  - Review report specifically meant to enhance the degree of confidence (to a "limited" extent) in the financial statements
  - Gather ***review evidence*** by performing review procedures
    - Review procedures consist primarily of analytical procedures and inquiries
  - To provide reasonable basis for obtaining "limited assurance"
  - That no material modifications needed so financial statements conform to applicable financial reporting framework used to prepare them
- If the accountant becomes believe the financial statements may be materially misstated, the accountant designs and performs additional procedures, as deemed necessary, to be able to conclude on the financial statements

Key Definitions in an AR-C Section 90 Engagement

- Analytical procedures
- Experienced accountant
- Inquiry
- Pervasive
- Review documentation

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Professional Skepticism

- An attitude that includes a questioning mind, alertness to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of review evidence
- Professional skepticism includes being alert to the following:
  - Review evidence that contradicts other review evidence obtained;
  - Information that brings into question the reliability of responses to inquiries and other information or records to be used as review evidence; and
  - Circumstances that suggest the need for additional review procedures
- Benefits of maintaining professional skepticism
  - Reduces the risks of overlooking unusual circumstances
  - Overgeneralizing when drawing conclusions from review observations
  - Using inappropriate assumptions in determining the nature, timing, and extent of the review procedures and evaluating the results thereof

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Consideration of Materiality in a Review Engagement

- Requirement for accountant to explicitly determine materiality
  - Apply concept in designing and performing review procedures
  - Should be revised when information obtained dictates
- Materiality is determined in the context of the applicable financial reporting framework, but generally considers the following:
  - Misstatements, individually or in the aggregate, that would influence the judgment made by a reasonable user based on the financial statements
  - Materiality judgments are made in light of surrounding circumstances and affected by the size or nature of a misstatement or a combination of both and consist of both qualitative and quantitative considerations
  - Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group, not specific individuals

Other Considerations Related to Materiality

- Accountant should use judgment if financial reporting framework used does not define materiality
- Assessment of materiality is the same regardless of the level of assurance provided by the engagement
- Level of materiality may need to be revised during an engagement for the following:
  - A change in the circumstances that occurred during the review
  - New information, or a change in the accountant's understanding of the entity and its environment as a result of performing review procedures

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Review Evidence and Limited Assurance

- SSARS No. 21 formally defines review evidence as:

> Information used by the accountant to provide a reasonable basis for obtaining limited assurance

- SSARS No. 25 adds formal definition of “limited assurance”
  - A level of assurance that is less than the reasonable level of assurance obtained in an audit engagement but is at an acceptable level as a basis for the conclusion expressed in an accountant’s review report
  - Obtained from review evidence obtained generally from inquiry and analytical procedures
  - A matter of professional judgment

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Risk Awareness

- SSARS No. 19 used “**risk awareness**,” not risk assessment
- Results of review procedures can modify accountant’s risk awareness:
  - Management’s response to inquiry that cash receipts are not deposited on daily basis might cause accountant to revise his/her risk awareness associated with client’s cash account
- “Risk awareness” <u>not</u> meant to imply accountant has to perform types of risk assessment procedures required in an audit:
  - May perform audit procedures but still a review engagement

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Business Risks

- ***Business risks*** – Not specifically used in SSARSs, but still need to be aware of when performing a review
- Professional auditing literature defines *business risks* as:

> Risks that result from significant conditions, events, circumstances, actions, or inactions that could adversely affect a company's ability to achieve its objectives and execute its strategies.
>
> Business risks also might result from setting inappropriate objectives and strategies or from changes or complexity in the company's operations or management.

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Review Risk

- **"Review risk"** – Not specifically used in SSARSs, but still need to be aware of when performing a review
- Risk you might unknowingly fail to modify your review report on financial statements that are materially misstated
- Analogy is *audit risk*:
  - Risk auditor expresses an inappropriate audit opinion when the financial statements are materially misstated

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Accountant’s Independence Requirements

- As an assurance service, the accountant must be independent to perform a review:
  - Assessment should occur before engagement acceptance
  - Continually monitor throughout the engagement
- Accountant should be familiar with AICPA *Code of Professional Conduct* (The Code):
  - “The Independence Rule” (Section 1.200 of the Code)
  - Various interpretations
  - Code Section 1.298, *Breach of Independence Interpretation*
    - Introduces remedies less than withdrawal

Review Engagement Client Acceptance and Continuance

- Consult AR-C section 60, paragraphs .30–.31
- Additional required procedures (similar to those for a compilation)
- Guidance in AR-C section 90, paragraphs .12–.15:
  - Managements responsibility for financial statements
  - Required disclosures for financial statements using special purpose framework
  - Management will provide a representation letter at end of engagement
  - Management agrees to include review report in any document containing financial statements
- Not required to but best practice to communicate with predecessor accountant
- Accountant should not accept the engagement if the above understandings are not obtained

Financial Statement Review Engagement Letter

- Formalizes understanding of key engagement terms
- Includes:
  - Mutual responsibilities
  - Limitations of review process
  - Financial statement framework to be used
  - Form of review report accountant expects to deliver
- SSARS No. 23 emphasized that understanding must be in writing
- SSARS No. 26 includes a technical revision that removed the requirement for an accountant to obtain a signed engagement letter prior to the start of the review engagement
  - This does not remove the requirement for the signed engagement letter but instead aligns the guidance with preparation engagements and compilation engagements
  - This revision was effective when issued

Basis for Review

- Must possess adequate knowledge of:
  - Understanding of client’s business and industry
  - Accounting principles/practices used by the client
- Must have sufficient knowledge to provide reasonable basis for opinion:
  - Inquiry, which provides a basis for analytical procedures
  - Unusual relationships and items
  - Related-party transactions, if applicable

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Elements of Business To Understand

- Operating characteristics
- Nature of assets, liabilities, revenues, and expenses
- Production and distribution methods
- Compensation methods
- Types of products and services
- Operating locations
- Material related-party transactions

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Designing and Performing Review Procedures

Designing Review Procedures

- Procedures provide evidence that supports "limited assurance"
  - Should address all material items, including disclosures
- Nature, timing, and extent are matter of professional judgment:
  - Based on knowledge of industry, business, and risk assessment
  - Perform more procedures in areas of greater risk
- Standard procedures are inquiry and analytics
  - May do other procedures, as necessary

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Important Notes

- Review evidence from performing analytical procedures and inquiries will ordinarily provide a reasonable basis for obtaining limited assurance
- Additional procedures might be needed:
  - Analytics reveal A/R increased much more than expected and management is not sure why – Use confirmations for additional review evidence
- Analytical procedures and inquiries are <u>not</u> simply “checklist” items:
  - “Tailor” nature/extent based on understanding of industry and client
  - Also consider “review risk” in this context as well

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Review Analytical Procedures

- Designed to identify relationships and unusual items that may reflect a material misstatement
- Based on plausible relationships reasonably expected to exist based on understanding of entity and its environment
- Matter of professional judgment
- Consider risk of material misstatement
- Document any procedures in response to significant unexpected differences in analytical procedures

Five Types of Analytical Procedures

- Flux or trend analysis
- Scanning analytics
- Ratio analysis
- Reasonableness tests
- Regression and other statistical analysis

Four-Step Analytics Process

- Develop expectation
- Set threshold for investigation
- Perform the analytical test
- Investigate results

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Developing Expectations

- "Predictions" of F/S amounts, account balances, or relationships between data:
  - Comparing this year's figures to last year's
  - Comparing actual results with budgeted amounts
  - Reviewing relationships between financial and nonfinancial information such as salaries/wages expense to number of employees
- Analytical procedures are meant to provide review evidence and help identify items that might be materially misstated

Factors Impacting Expectations

- Precision required – More precise → more comfort
- Impact of new, unusual, or complex situations:
  - Business combinations or other business changes
  - Unusual or complex transactions
  - New or complex accounting standards
  - Asset impairment
  - Segment disposal
  - Related party transactions
- Consider performing on disaggregated data

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Documenting Expectations

- Should develop expectations first:
  - Critical element of review evidence
- Example of developing an expectation:
  - Review of company performed each of last five years, with no significant changes in any year
  - Trend is expected to continue based on discussion with owner-manager
  - All changes greater than five percent will be further analyzed

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Developing Expectations Exercise

Developing Expectations

Assume that you are reviewing the 20X1 financial statements of Acme Automotive, a small parts manufacturer for the U.S. automobile industry. Because of the significant downturn in U.S. economy, you reasonably expect sales to decrease. Based on your knowledge of the U.S. automobile industry and Acme's business, you expect to see a 20% decrease in sales. Along with this expected decrease in sales, you also expect a corresponding decrease in Acme's cost of goods sold and its accounts receivable and accounts payable. Acme's financial statements include the following data:

	20X1	20X0	Difference	% Difference
Sales	988,683	1,214,598	(225,915)	(18.6)%
Cost of Sales	744,718	901,128	(156,410)	(17.4)%
Gross Profit	243,965	313,470		
Gross Profit %	24.7	25.8		
Accounts Receivable	456,963	526,888	(69,925)	(13.3)%
Days Sales in	169	158	11	7%
Accts Payable	498,742	587,564	(88,822)	(15.1)%

Considering your expectations and given the above results, how would you conclude as to Acme's sales, costs of sales, accounts receivable, and accounts payable figures?

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“Flux Analysis” and Scanning

- “**Flux analysis**” – Comparing recorded amounts (or ratios) with expectations and following up on inconsistent results
- **Scanning** – Reviewing (scanning) various sources of financial information to identify any significant/unusual items for follow up:
  - Significant/unusual items – Based on professional judgment; should reflect circumstances of review engagement (“tailored”)

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Other Analytical Procedures

- While trend analysis is the most common, use the other types of analytical procedures as need be:
  - Trend analysis is essentially a multi-year flux analysis
- Ratio analysis – Involves more than one variable
- Reasonableness test – Non-statistical model
- Statistical modeling, such as regression analysis
  - Generally only used as an audit procedure

> - Focus on areas of increased risk of misstatement
> - Tailor procedures based on knowledge of client and industry
> - Use professional judgment to determine nature, timing, and extent of analytical procedures at both F/S and detailed account levels

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Limitations of Analytical Procedures

- Subjective – Professional judgment involved in determining nature, timing, and extent
- Materiality – Plays a part in design and performance
- Many based on past to present relationship – Might not hold true
- Can be negatively affected by underlying data – Garbage in, garbage out
- Use of accounting estimates – Can skew expectations/outcomes
- Consider impact of adoption of new accounting standards
  - Are financial statements comparable?
  - Cumulative effect adjustment
  - Adjust expectations and assess reasonableness of management explanations

Investigating the Results of Analytical Procedures

- The results of the analytic procedure needs to be investigated if the result is outside the established acceptable threshold for investigation
  - Link to overall assessment of materiality
  - Inquire of management as to the cause of the unexpected result or consider performing additional analytical procedures in order to obtain the level of assurance required to support the review opinion
  - While the explanations obtained from management need to be plausible, they do not need to be corroborated with other substantive evidence, as would be the case with an audit
    - However, even a reasonable explanation from the client may result in the accountant performing additional review procedures
    - Additionally, the accountant should get an explanation for the full variance, not just the amount that exceeds the threshold
  - Be alert for offsetting explanations, which net to a small number

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Review Inquiries

- Nature and extent matter of professional judgment:
  - Management and those with financial reporting and accounting responsibilities
- Should consider risk of material misstatement
- Should consider prior engagement evidence
- Consider impact of newly adopted accounting standards
- Corroboration not necessarily required
- Document significant matters covered
- Inquiry consists of seeking information of knowledgeable persons within or outside the entity

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Review Inquiries

- Fundamental procedure performed for <u>every</u> review engagement
- Used independently of and in connection with analytical procedures
- Should be tailored to each individual review
- Not simply “same old same old” checklist questions:
  - Not asked in a mechanical fashion
  - Not answered in a mechanical fashion

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"Standard" Inquiries

- Have the financial statements been prepared in conformity with the applicable financial reporting framework? How did management determine that estimates are reasonable?
- Who are related parties and transactions? What are their purposes?
- Are there significant, unusual, or complex situations, transactions, events, or manners that would affect the financial statements?
  - SSARS No. 25 expanded this inquiry to include significant changes in business activities or operations, significant changes to contract terms, significant journal entries or adjustments, significant late-period transactions, status of uncorrected misstatements from prior review, and effects of related party transactions
- Matters identified during analytical review
- Are there any actual, suspected or alleged fraud or noncompliance with laws and regulations which would impact the financial statements?
- Has management identified, addressed, appropriately accounted for subsequent events?
- What is management's basis for its assessment of entity's ability to continue as a going concern and anything that threatens this?
- Whether there are events or conditions that appear to cast doubt on the entity's ability to continue as a going concern (added by SSARS No. 25)

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"Standard" Inquiries

- Are there any material commitments, contractual obligations, or contingencies which would affect the financial statements?
- Are there any material nonmonetary transactions or transactions for no consideration in the financial reporting period under consideration?
- Are there any communications from regulatory agencies?
- Are there any litigation, claims, and assessments that existed at the date of the balance sheet being reported on and during the period from the balance sheet date to the date of management's response to the accountant's inquiry?
- What actions were taken at meetings of stockholders, the board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements?
- Ask about any other matters, as necessary

Specific Review Procedures

- When there is an indication that fraud or noncompliance with laws or regulations has or is suspected to have occurred:
  - Communicate identified or suspected fraud as soon as practical to the appropriate level of senior management or those charged with governance, as appropriate
  - Communicate to management identified or suspected noncompliance with laws and regulations whose effects should be considered when preparing financial statements, other than those clearly inconsequential
  - Request management's assessment of the effects, if any, on the financial statements
  - Consider the effect, if any, of management's assessment of the effects on the accountant's conclusion on the financial statements and on the accountant's report
  - Determine whether a reporting requirement exists
  - Consider obtaining legal advice or withdrawing from the engagement, as necessary

Specific Review Procedures

- Related parties
  - Be alert to existence of non-identified related party transactions
  - When identified, inquire as to the nature and parties
  - Determine appropriate accounting and disclosures
- Using the work of others
  - If using work performed by other accountants or the work of someone whose expertise is not in financial reporting, the accountant must assess that the work is adequate for the accountant's purposes
- Accountant should obtain evidence that the financial statements agree or reconcile with the entity's accounting records

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Additional Procedures When the Financial Statements May Be Materially Misstated

- If the accountant believes the financial statements may be materially misstated, the accountant should design and perform additional procedures sufficient to enable the accountant to either:
  - Conclude that the matter or matters are not likely to cause the financial statements as a whole to be materially misstated or
  - Determine that the matter or matters cause the financial statements as a whole to be materially misstated
- The response will vary, based on the circumstances, is based on professional judgment, information already obtained, and the persuasiveness of review evidence needed to address the matter
- The additional procedures may consist of additional inquiry or analytical procedures, or other types of procedures

Substantial Doubt

- U.S. GAAP requires <u>management</u> to assess entity's ability to continue as going concern and provide related footnote disclosures
- Probable unable to meet obligations coming due within one year after F/S issued or available to be issued
  - Both interim and annual periods
- Based on conditions/events reasonably knowable at date F/S issued or available to be issued
  - Individual and in the aggregate

Final Exercise – Questions for Discussion

1. How could you improve the level of your firm's review engagement documentation?
2. What aspects of analytical procedures are challenging for you?
3. Do you use audit procedures when conducting a review?

Thank you!

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