January 3, 2013

Michael P. Glynn, CPA
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AICPA
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Re: June 29, 2012 ARSC Exposure Draft (ED) of Proposed Statements on Standards for Accounting and Review Services (SSARSSs):

- Association with Unaudited Financial Statements (the Association proposal)
- Compilation of Financial Statements
- Compilation of Financial Statements—Special Considerations

Dear Mr. Glynn:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to represent the views of local and regional firms on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective.

TIC has appreciated the extra time that was afforded by the extension of the comment letter deadline and other staff considerations to review and discuss these important proposals. TIC has provided the following comments for the Accounting and Review Services Committee’s (ARSC’s) consideration.

GENERAL COMMENTS

The Government Accountability Office’s (GAO’s) action to change the definition of nonattest services to include preparation of financial statements (and a similar proposal by the Professional Ethics Executive Committee (PEEC) to conform to the GAO definition), has prompted ARSC to reexamine the definition and scope of a compilation engagement on an accelerated schedule. The proposed changes to the definition and scope of a compilation engagement and the adoption of the new Association ED, which, in part, discusses the accountant’s responsibilities for financial statements that the accountant has prepared but has not audited, reviewed or compiled, prompt many emotions and thought-provoking questions and challenge how we think about the performance of bookkeeping/preparation services for clients. TIC is supportive of the need for change but cannot support the proposed direction outlined in the EDs.
TIC recommends that the current proposals and the existing compilation standard be withdrawn and that ARSC develop a new standard that would provide authoritative guidance for engagements involving nonattest bookkeeping and financial statement preparation services.

**SPECIFIC COMMENTS**

**TIC’s Concerns**

TIC believes the proposed standards will cause confusion among CPA firms, financial statement preparers and users and will not be an improvement over current standards.

The proposals fail to provide a clear distinction between the nonattest preparation service and the attest compilation engagement. The terms “prepare” and “compile” are viewed as synonyms by many financial statement preparers and users, especially since the extant compilation standard requires CPAs to perform a compilation engagement when they have prepared financial statements for a client. The proposed change would require significant educational efforts for the benefit of financial statement users concerning the proposed separation of the concepts. TIC expects that users will also have difficulty understanding why independence is required to be reported if the financial statements are prepared under the optional attest compilation standard but is not required if they are prepared as a nonattest preparation engagement.

The proposals as written fail to present a clear picture of the accountant’s performance obligations for engagements involving preparation, in whole or in part, of an entity’s financial statements. From the practitioner’s perspective, the compilation attest engagement may seem to be more rigorous than the nonattest preparation service. For example, the Association proposal fails to mention that an accountant has responsibilities to comply with the AICPA Code of Professional Conduct (the AICPA Code) in the performance of professional services. These responsibilities are part of the performance requirements of the extent compilation standard, which elaborates on the basic ethics requirements in some detail. Without this reminder, TIC is concerned that many members may not realize that the AICPA Code applies to nonattest services, as well as to attest services.

In addition, paragraph 6b of the Association proposal is very unclear as written. It requires the accountant who wants to permit the use of his/her name in the document containing the financial statements to “consider whether the unaudited financial statements appear free from material inconsistencies with other knowledge or information of which the accountant may be aware.” This requirement sounds very much like the “reading” requirement in the extant compilation standard. TIC believes practitioners will not understand the difference.

The reporting guidance in paragraphs 6c and 7 of the Association proposal are not sufficiently clear as to the nature of the accountant’s involvement with the financial statements. Financial statement users, in particular, may be confused by the wording in
the legend appearing on financial statements (or in the optional accountant’s report) that
dates the financial statements have not been audited, reviewed or compiled and that no
assurance is provided. The language suggests that, if the financial statements are
compiled, there is some form of “assurance” provided by the accountant. If the users
know that the CPA was engaged to prepare the financial statements, they will not
understand the CPA’s involvement or responsibility.

TIC also questions whether the legend is necessary if the accountant does not want
his/her name associated with the financial statements that he/she has prepared or
assisted in preparing. The suggested language for the financial statement legend (i.e., “the
financial statements were not compiled, reviewed or audited”) uses accountant’s
terminology and thereby implies that a CPA was involved with the financial statements in
some way. If the accountant does not want to consent to the use of his/her name in the
document, then the financial statements should be “plain paper.” However, whenever a
report or legend is appended to the financial statements that the accountant has
prepared, TIC believes the language in the report or legend should include a statement
that the financial statements are the responsibility of management.

Although the proposals are designed to remove the ambiguity surrounding the “prepare
and present” criteria in the extant compilation standard, TIC believes new questions will
arise surrounding the verbiage “prepare in whole or in part.” Although this language had
been present in AU 504, Association with Financial Statements, many practitioners may be
unaware that it existed. It will appear as a new idea to some and raises the question
“What does it mean to prepare financial statements “in part”?

TIC is also concerned with the effect that the proposals will have on engagement
monitoring through peer review. TIC members who perform peer reviews of compilation
engagements today frequently uncover problems with financial statements prepared by
the reviewed firm. Some firms fail peer review because of deficiencies in these
engagements. Potentially, financial statements prepared under a nonattest services
engagement could fall outside of the scope of peer review, thereby eliminating the ability
of the profession to monitor the quality of such engagements. TIC suggests that ARSC
coordinate with AICPA’s Peer Review Board and the National Association of State Boards
of Accountancy (NASBA) to study the potential effect of the proposals on quality
monitoring to appropriately consider the best course of action for the public interest.

TIC disagrees with the proposal in paragraph 10 of the Compilation ED which would
require the engagement letter to be signed by the client. TIC believes that an engagement
letter should be required for each engagement. However, obtaining the client’s signature
should be a risk-management decision on the part of each firm and should not be
mandated. The standard should require that the accountant document that the terms of
the engagement were discussed with the client and that the client has agreed to the
stated terms.

Finally, the proposals contain no requirements or guidance to advise practitioners that
the financial statements they prepare should include communications about the basis of
accounting used in the financial statements and any known departures from that basis of accounting. Such communications would be included in the extant compilation report to third parties but are not explicitly required in the proposals if the financial statements are prepared as a nonattest engagement. Although the AICPA’s Code advises members that they cannot be associated with misleading financial statements, the AICPA Code provides only general guidance as to a member’s responsibilities. TIC believes these issues need to be specifically addressed in a standard, especially if nonattest engagements will not be subject to peer review.

TIC has reviewed many of the comment letters that ARSC has already received and noticed that certain respondents favored the changes proposed in the Association and Compilation proposals while others strongly disagreed with the proposed direction. TIC’s constituency is clearly divided on the issues. TIC considered these comments along with its own concerns about the EDs and also looked at how the compilation service has changed in recent years.

Traditionally, the CPA was engaged to prepare a full set of financial statements for a client. Today, however, technology and other factors (cost, client sophistication, etc.) have allowed clients to take on more responsibilities for preparation. As a result, it is becoming more common for CPAs to be engaged to perform a range of preparation services, which can vary considerably in nature and extent from client to client. Many who favored the proposals as written said that the users of the financial statements did not need a report from the CPA. The reporting requirements of the extant compilation standard are not as relevant to the service that many practitioners have been engaged to perform. Similarly, if the client engages a CPA to prepare one footnote and nothing else, many also question why the CPA should have to read the entire set of financial statements and comply with other performance requirements when that is not what the CPA was engaged to do.

Another concern with the extant compilation standard is the perceived expectation gap that exists between the financial statement user and the CPA firm. Anecdotal evidence suggests that lenders and many other third-party users place too much “reliance” on financial statements that have been compiled, even though the compilation report clearly states that the accountant is not obtaining or providing any assurance. At a minimum, it is clear that external users derive “value” from a compilation report and that value is more than inconsequential. The proposals do not address this problem and may have the effect of increasing the expectation gap.

Despite their flaws, TIC realizes that the proposals have attempted to address certain existing concerns about the extant compilation standard, as well as the ramifications of the proposed re-definition of preparation as a nonattest service.

TIC has therefore concluded that significant change is needed to address the issues that exist today with compilation engagements. Although TIC cannot support the Association and Compilation proposals as written, based on the concerns cited above, TIC would be supportive of significant revisions to the standards if they took a different direction.
TIC’s Recommendations

TIC believes the existence of two different standards for essentially the same service adds unnecessary complexity to the SSARSs and should be avoided. TIC therefore recommends that the Association and Compilation proposals be withdrawn and that ARSC move in a new direction. TIC understands that ARSC has been discussing other options to the proposals. TIC would like to express its support for the following ideas, which have surfaced during TIC’s normal deliberations and conversations with AICPA staff and others:

- The attest compilation service should be eliminated from the SSARSs. Since preparation of the financial statements in whole or in part is to be defined as a nonattest service based on the PEEC ED, the attest compilation service model is no longer operational.

- ARSC should develop a new standard for nonattest accounting services. Key considerations for the new standard would include:
  
  o Independence – By definition, this standard would not require the accountant to be independent of the client because accounting services would not be attest services. (Dropping the independence reporting requirement for non-assurance services would also conform to international ethics and compilation standards.)

  o Scope – ARSC should consider whether the scope of the new standard would cover all bookkeeping and financial statement preparation services. A standard whose scope covers a broad range of services could eliminate any concerns as to the meaning of preparation in whole or in part.

  o Use of the Accountant’s Name/Association – ARSC should incorporate guidance for an accountant's association with financial statements into a new accounting services standard, which would distinguish legal association from association by use of the accountant's name. Similarly, each standard for other engagements (such as review engagements) should include similar association guidance.

  o Engagement Letters – TIC believes that an engagement letter should be required for every accounting services engagement. The standard should require that the accountant document that the terms of the engagement were discussed with the client and that the client has agreed to the stated terms. Obtaining an engagement letter that is signed by the client would be an option, not a requirement.
o Ethical Responsibilities – ARSC should provide more explicit discussion of professional responsibilities in the new standard. Simply cross-referencing to the AICPA Code is not sufficient.

o Reporting – ARSC should consider whether an accountant’s report is ever recommended and, if so, what language should be used. ARSC also would need to decide if a report should ever be a requirement under certain circumstances.

o ARSC should coordinate with the AICPA Peer Review Board and NASBA before re-exposing the proposals for public comment.

If ARSC decides to withdraw the current ED and issue a proposal for a new accounting services standard, TIC would be happy to assist ARSC in any way it can at any point in the process.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Karen Kerber, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees