Agenda Item 4

Proposed clarified SSARS, *Compilation of Financial Statements*

**Objective of Agenda Item**
To review and discuss the first read draft of the proposed clarified SSARS, *Compilation of Financial Statements* and provide the Task Force with additional guidance.

**Background**
At its meeting in May 2010, the ARSC approved a project to clarify the existing SSARSs literature utilizing the clarity drafting conventions adopted by the Auditing Standards Board in its project to clarify the auditing literature. However, the ARSC’s determined that as opposed to using the international literature as a base, that it would use the extant SSARSs as the base. The ARSC will separately consider convergence with the international literature once the International Auditing and Assurance Standards Board completes its revision of the international compilation and review literature.

In January 2011, the ARSC formed the Clarity Task Force. ARSC member Chas McElroy was appointed as Chair of the Task Force. The Task Force was charged with drafting the clarified SSARSs for presentation to the full ARSC using the clarity drafting conventions and considering the appropriateness of extant requirements and guidance. Each member of the current ARSC was charged with drafting specific sections of the clarified compilation SSARS. The Task Force met on March 29, 2011 to review the draft of the proposed compilation SSARS and to make suggestions as to how the proposed SSARS could be improved.

**Issues For Discussion With the ARSC**

**Submission of Financial Statements**
Prior to the issuance of SSARS No. 1 in December 1978, the ARSC determined that the accountant should be required to compile and report on financial statements whenever he or she submitted (defined as prepared and presented) financial statements to his or her client or to third parties. After SSARS No. 1 was issued, the ARSC determined that it was in the public interest to provide certain exceptions to the requirement that the accountant report whenever he or she submits financial statements to a client or third parties. In September 1986, the ARSC issued SSARS No. 6, *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* which provided an exemption from the reporting requirements for personal financial statements that are included in written personal financial plans prepared by the accountant, and specified the form of written report required under the exception. In October 2000, the ARSC issued
SSARS No. 8, *Amendment to Statement on Standards for Accounting and Review Services No. 1* which, among other things, provided an exception from the reporting requirements when the accountant submits compiled financial statements to his or her client that are not expected to be used by a third party.

Additionally, in an attempt to provide appropriate guidance to accountants regarding developing issues, the ARSC has issued several Interpretations to AR section 100 (superseded by SSARS No. 19 – the compilation literature is currently codified as AR section 80). Those Interpretations included:

- Interpretation No. 15, “Differentiating a Financial Statement Presentation From a Trial Balance”
- Interpretation No. 16, “Determining if the Accountant Has “Submitted” Financial Statements Even When Not Engaged to Compile or Review Financial Statements”
- Interpretation No. 17, “Submitting Draft Financial Statements”
- Interpretation No. 20, “Applicability of Statements on Standards for Accounting and Review Services to Litigation Services”
- Interpretation No. 21, “Applicability of SSARS No. 1 When Performing Controllership or Other Management Services”
- Interpretation No. 31, “Preparation of Financial Statements for Use by an Entity’s Auditors”

The AICPA’s Audit and Attest Standards Team also issued numerous Technical Practice Aids intended to provide guidance to accountants on the subject of submission of financial statements.

In July 2005, the ARSC issued SSARS No. 13, *Compilation of Specified Elements, Accounts, or Items of a Financial Statement* and SSARS No. 14, *Compilation of Pro Forma Financial Information*. The ARSC determined that with respect to a compilation of specified elements, accounts, or items of a financial statement or pro forma financial information, the accountant would not be required to issue a report unless the accountant was engaged to do so. SSARS Nos. 13 and 14, however, did contain a risk consideration whereby the accountant is required to consider how the presentation of specified elements, accounts, or items of a financial statement or pro forma financial information would be used. If the accountant determined that there was a likelihood that a user of the compiled information would infer an unintended level of reliance on the information based on the accountant’s association with such information, the accountant should consider issuing a compilation report. SSARS Nos. 13 and 14 introduced the concept of an engagement driven compilation engagement to the SSARSs literature.

In addition to SSARS Nos. 13 and 14, the SSARSs review literature as well as the SAS auditing literature does not require the accountant/auditor to issue a report unless engaged to do so. The proposed International Standard on Related Services 4410 (Revised), *Compilation Engagements* likewise does not require the accountant to issue a report unless he or she is engaged to do so.
**Action Requested of the ARSC**
The ARSC is asked to consider the pros and cons of a submission driven compilation reporting requirement and whether ARSC would support moving from a submission driven compilation standard to an engagement driven reporting standard (as contemplated by IAASB) for all compilations.

**Communications With Predecessor Accountant**
Extant AR section 400 provides guidance on communications between a predecessor and successor accountant when the successor accountant decides to communicate with the predecessor accountant regarding acceptance of an engagement to compile (or review) the financial statements of a nonissuer. The source of AR section 400 is SSARS No. 4, which was issued in December 1981.

The Clarity Task Force believes that the requirements in AR section 400 are not necessary since, in practice, successor accountants rarely communicate with predecessor accountants in the acceptance of a compilation engagement. Therefore, the Clarity Task Force is proposing that the proposed clarified compilation SSARS include a requirement stating that an accountant is not required to communicate with a predecessor accountant in connection with acceptance of a compilation engagement, but that he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement. All other requirements and guidance in extant AR section 400 would not be retained.

**Action Requested of the ARSC**
The ARSC is asked to consider whether it agrees with the Clarity Task Force’s determination to not include the requirements and guidance from AR section 400 in the proposed clarified compilation SSARS.

**Management’s Responsibilities**
SSARS No. 19 includes the following discussion of management’s responsibilities (footnote omitted):

*Management (Responsible Party)*

1.30 Management responsibilities include taking responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and taking responsibility for designing, implementing, and maintaining internal control.

1.31 A basic premise underlying the performance of a compilation or review engagement is that the accountant is performing an attest service on subject matter that is the responsibility of the client’s management. Therefore, an accountant is precluded from issuing an unmodified compilation report or a review report on financial statements when management is unwilling to accept responsibility for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework.
or to take responsibility for the design, implementation, and maintenance of internal control.

1.32 As part of their responsibility for the preparation and presentation of the financial statements, management and, when appropriate, those charged with governance are responsible for the identification of the applicable financial reporting framework and the preparation and presentation of the financial statements in accordance with that framework.

1.33 During the performance of a compilation or review engagement, the accountant may make suggestions about the form or content of the financial statements or prepare them, in whole or in part, based on information that is the representation of management.

In addition, the illustrative engagement letters as well as the compilation reporting requirements discuss management’s responsibility for the preparation and fair presentation of the financial statements.

After the issuance of SSARS No. 19, some have argued that it is possible for the accountant to accept an engagement whereby management outsources its responsibility for the preparation and fair presentation of the financial statements to the accountant. Others have argued that although the accountant can accept an engagement whereby it prepares the financial statements in accordance with the applicable financial reporting framework, the responsibility for the preparation and fair presentation of those financial statements always rests with management. In the outsourcing scenario, the accountant is merely performing a mechanical function and management exercised its responsibility by outsourcing the mechanics.

**Action Requested of the ARSC**

The ARSC is asked to consider the scenario whereby management outsources the preparation and fair presentation of the financial statements and in that case, who has the responsibility for the preparation and fair presentation of the financial statements.

The ARSC is to consider the effects, if any, its consideration has on the illustrative engagement letters and the compilation reporting requirements.

**Appropriate Level of Knowledge of the Entity in a Compilation Engagement**

As part of the discussions prior to the issuance of SSARS No. 19, the ARSC considered whether the appropriate level of knowledge that the accountant was required to obtain in order to compile financial statements. SSARS No. 19 included the following:

**Knowledge of the Client**

2.8 The accountant should obtain knowledge about the client, including

- an understanding of the client’s business and
- an understanding of the accounting principles and practices used by the client.
2.9 In obtaining an understanding of the client’s business, the accountant should have a general understanding of the client’s organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses. The accountant’s understanding of the entity’s business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity’s personnel.

2.10 The accountant should obtain an understanding of the accounting principles and practices used by the client in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant’s understanding also may include matters such as changes in accounting practices and principles and differences in the client’s business model as compared with normal practices within the industry.

2.11 In obtaining this understanding of the client’s accounting policies and practices, the accountant should be alert to unusual accounting policies and procedures that come to the accountant’s attention as a result of his or her knowledge of the industry.

The preceding is consistent with the corresponding guidance in the SSARSs review literature.

The proposed International Standard on Related Services 4410, *Compilation Engagements*, includes the following as application guidance with respect to the practitioner’s knowledge and understanding:

A42. The breadth and depth of the knowledge and understanding the practitioner has or obtains about the entity and its business is less than that which is possessed by management. It is directed at the level that is sufficient for the practitioner to be able to present the compiled financial information in accordance with the applicable financial reporting framework and the terms of the engagement, and to comply with this ISRS.

A43. Examples of relevant factors the practitioner may consider in developing a knowledge and understanding of the entity’s business and operations include:

- The size and complexity of the entity and its operations.
- The complexity of the applicable financial reporting framework.
- The entity’s financial reporting obligations or requirements, whether they exist under applicable laws and regulation or in the context of voluntary financial reporting arrangements, for example with third parties.
- The level of development of the entity’s management and governance structure regarding management and oversight of the entity’s accounting records and financial reporting systems that underpin the preparation of financial information for financial reporting purposes.
- The degree of complexity or otherwise of the entity’s financial accounting and reporting systems.
- The level of development and proper design or relative sophistication of the entity’s accounting systems and related controls through which the entity’s accounting records and related information is maintained.

**Action Requested of the ARSC**
The ARSC is asked to consider the requirements and guidance contained within the proposed clarified compilation SSARSs with respect to the accountant’s knowledge of the entity. Specifically consider the appropriateness of the level of knowledge. The ARSC is asked to consider whether the guidance in the proposed ISRS 4410 is more appropriate (the ISRS 4410 requirements are fairly consistent with extant SSARSs).

**Requirement to read the financial statements**
Paragraph .13 of AR section 80 reads, in part, as follows (emphasis added):

> Before submission, the accountant **should** read the financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors.

The Clarity Task Force proposes that the requirement be clarified by replacing the word “should” with “**is required to**”. The Clarity Task Force is aware that the ARSC has generally drafted its requirements as presumptively mandatory requirements as opposed to unconditional requirements however, the Clarity Task Force is of the belief that since it is not possible to perform a compilation of financial statements without reading such financial statements, that the unconditional requirement is appropriate in this situation.

**Action Requested of the ARSC**
The ARSC is asked to consider the proposal to revise the requirement to read the financial statements from a presumptively mandatory requirement to an unconditional requirement.

**Documentation in a compilation engagement**
In addition to the documentation requirements in extant AR section 80, the Clarity Task Force proposes that the accountant’s documentation also include a copy of the compiled financial statements and the accountant’s compilation report. This requirement is consistent with the proposed International Standard on Related Services (Revised), *Compilation Engagements*.

**Action Requested of the ARSC**
The ARSC is asked to consider whether it agrees with the proposed additional documentation requirement.

**Accountant’s Compilation Report on Financial Statements Prepared in Accordance With an OCBOA**
Paragraph .19 of extant AR section 80 reads as follows:

.19 Financial statements prepared in accordance with an OCBOA are not considered appropriate in form unless the financial statements include

a. a description of the OCBOA, including a summary of significant accounting policies and a description of the primary differences from generally accepted accounting principles (GAAP). The effects of the differences need not be quantified.

b. informative disclosures similar to those required by GAAP if the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

The draft proposed clarified compilation SSARSs does not include the above paragraph but, instead includes expanded requirements and guidance regarding compilations of financial statements prepared in accordance with an OCBOA. The new requirements and guidance is based on the requirements and guidance in the clarified SAS, Special Considerations – Audits of Financial Statements Prepared in Accordance With a Special Purpose Framework. The clarified SAS refers to OCBOA financial statements as financial statements prepared in accordance with a special purpose framework. The ARSC previously concluded that the use of the term OCBOA remains appropriate in the SSARSs literature due to the wide spread understanding of the term among practitioners and users of compiled and reviewed financial statements. The ARSC felt that it was in the public interest to retain the term OCBOA.

The proposed requirements include:

- A requirement for the accountant to consider whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the OCBOA differs from GAAP.

- A requirement for the accountant to consider whether the financial statements include informative disclosures when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

- A requirement that the compilation report include a statement in the section “Management’s Responsibility for the Financial Statements” that states that management is responsible for determining that the OCBOA is acceptable in the circumstances (when management has a choice of frameworks).

- A requirement that the compilation report include an emphasis-of-matter paragraph that indicates that the OCBOA is a basis of accounting other than GAAP (this was a pre-SSARS 19 requirement that several members have questioned whether it should be reinstated).
The corresponding SAS requirements run to an evaluation instead of a consideration in the first two preceding bullet points.

**Action Requested of the ARSC**
The ARSC is asked to consider whether it agrees with proposed requirements and guidance regarding a compilation of financial statements prepared in accordance with an OCBOA.

**Reporting on Compiled Financial Statements Included in Certain Prescribed Forms**
Interpretation No. 1 to AR section 300 entitled “Omission of Disclosures in Certain Prescribed Forms” states that, in the case where the accountant has reviewed financial statements including disclosures required by accounting principles generally accepted in the United States of America and is asked to compile financial statements in a prescribed form that does not request such disclosures, if the measurement principles to be used do not cause the compiled financial statements in the prescribed form to be materially different from the reviewed statements, the accountant’s compilation report on the prescribed form can refer to the accountant’s report on reviewed financial statements.

The Task Force believes that the accountant can refer to a previously issued (compilation, review, or audit) report on such financial statements even if the measurement principles do not cause the compiled financial statements in the prescribed form to be materially different from the (compiled, reviewed, or audited) financial statements. Accordingly, the Task Force determined to include the following in the application material:

A70. The accountant may have compiled, reviewed, or audited financial statements including disclosures required by accounting principles generally accepted in the United States of America and compile financial statements included in a prescribed form which does not include such disclosures. The accountant’s compilation report on the prescribed form may refer to the accountant’s report on the reviewed financial statements. Paragraphs XX-XX provides guidance with respect to financial statements that omit substantially all disclosures.

**Action Requested of the ARSC**
The ARSC is asked to consider whether it agrees with the application material included in the proposed clarified compilation SSARS.

As part of conforming AR section 300, *Compilation Reports on Financial Statements Included in Certain Prescribed Forms*, the ARSC determined to provide two illustrative reports. The first report illustrates how an accountant may report when the compiled financial statements are included in a prescribed form that calls for a presentation departure from accounting principles generally accepted in the United States of America. That report, as included in Exhibit B to the draft proposed clarified compilation SSARS, reads as follows:
ACCOUNTANT’S COMPILATION REPORT

[Appropriate Addressee]

I (we) have compiled the (identification of financial statements, including period covered and the name of entity) included in the accompanying prescribed form. I (we) have not audited or reviewed the financial statements included in the accompanying prescribed form and, accordingly, do not express an opinion or provide any assurance about whether the financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management’s Responsibility for the Financial Statements

Management (owners) is (are) responsible for the preparation and fair presentation of the financial statements included in the form prescribed by (name of body) in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Accountant’s Responsibility

My (our) responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

Other Matter

The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of [name of body], and are not intended to be a presentation in accordance with accounting principles generally accepted in the United States of America.

Intended Use

This report is intended solely for the information and use of [the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

[Signature of accounting firm or accountant, as appropriate]

[Accountant’s city and state]

[Date of the accountant’s report]

Certain members of the Task Force have questioned whether the above report is practical as they believe that this scenario where the prescribed form calls for a presentation departure from GAAP does not occur in practice.
Action Requested of the ARSC
The ARSC is asked to consider whether it agrees with the proposed treatment of known departures from the applicable financial reporting framework in the accountant’s compilation report.

The proposed clarified compilation SSARS includes a requirement that departures from the applicable financial reporting framework be disclosed in the accountant’s compilation report in a separate section entitled “Known Departure From [the applicable financial reporting framework]”. The Task Force considered whether such departures should be disclosed in an Other Matter paragraph but, concluded that such treatment would be inconsistent with how a known departure is addressed in an auditor’s report. In an auditor’s report, the auditor would generally disclose the known departure in a section entitled “Qualified Opinion”. Since there is no opinion or conclusion section of the accountant’s compilation report, the Task Force determined that a separate section is warranted.

Action Requested of the ARSC
The ARSC is asked to consider whether it agrees with proposed requirements in the circumstances outlined above.

Accountant’s preclusion from downgrading to a compilation report
Paragraphs .56-.57 of AR section 80 states that the accountant “ordinary would” be precluded from issuing a compilation report on financial statements when:

- The accountant has been engaged to audit the financial statements and has been prohibited by the entity from corresponding with the entity’s legal counsel.

- The client does not provide the accountant with a signed representation letter in an audit or review engagement.

The proposed SSARSs states that the accountant “unless there are extenuating circumstances, is” precluded from issuing a compilation report in those circumstances.

Action Requested of the ARSC
The ARSC is asked to consider whether it agrees with proposed requirements in the circumstances outlined above.
Agenda Items Presented:

Agenda item 4A  Draft proposed clarified SSARS, *Compilation of Financial Statements* – submission driven convention (through documentation requirements)

Agenda item 4B  Draft proposed clarified SSARS, *Compilation of Financial Statements* – redline to show changes necessary for an engagement driven convention (through documentation requirements)

Agenda item 4C  Draft proposed clarified SSARS, *Compilation of Financial Statements* – submission driven convention (general reporting and reporting on comparative financial statements)

Agenda item 4D  Draft proposed clarified SSARS, *Compilation of Financial Statements* – redline to show changes necessary for an engagement driven convention (general reporting and reporting on comparative financial statements)

Agenda item 4E  Draft proposed clarified SSARS, *Compilation of Financial Statements* (special reporting requirements)

Agenda item 4F  Draft proposed clarified SSARS, *Compilation of Financial Statements* – submission driven convention (Management Use Only financial statements through Intended Use Reporting)

Agenda item 4G  Draft proposed clarified SSARS, *Compilation of Financial Statements* – redline to show changes necessary for an engagement driven convention (Management Use Only financial statements through Intended Use Reporting)

Agenda item 4H  Draft proposed clarified SSARS, *Compilation of Financial Statements* – submission driven convention (going concern considerations through change in engagement)

Agenda item 4I  Draft proposed clarified SSARS, *Compilation of Financial Statements* – redline to show changes necessary for an engagement driven convention (going concern considerations through change in engagement)

Agenda item 4J  Draft proposed clarified SSARS, *Compilation of Financial Statements* full document under a submission driven convention

Agenda item 4K  Draft proposed clarified SSARS, *Compilation of Financial Statements* full document redlined to show changes necessary for an engagement driven convention
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