

## AR-C Section 70

# *Preparation of Financial Statements*

Source: SSARS No. 21

Effective for the preparation of financial statements for periods ending on or after December 15, 2015.

## Introduction

### Scope of This Section

.01 This section applies when an accountant in public practice is engaged to prepare financial statements. This section does not apply when an accountant prepares financial statements

- and is engaged to perform an audit, review, or compilation of those financial statements,
- solely for submission to taxing authorities,
- for inclusion in written personal financial plans prepared by the accountant,
- in conjunction with litigation services that involve pending or potential legal or regulatory proceedings, or
- in conjunction with business valuation services.

This section may also be applied, adapted as necessary in the circumstances, to the preparation of other historical or prospective financial information.<sup>1</sup> (Ref: par. .A1)

.02 The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on services the client requests the accountant to perform and requires the accountant to apply professional judgment. (Ref: par. .A2)

### The Preparation Engagement

.03 An engagement to prepare financial statements is a nonattest service and does not require a determination about whether the accountant is independent of the entity. (Ref: par. .A3)

.04 In addition, an engagement to prepare financial statements does not require the accountant to verify the accuracy or completeness of the information provided by management or otherwise gather evidence to express an opinion or a conclusion on the financial statements or otherwise report on the financial statements.

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<sup>1</sup> The Accounting and Review Services Committee plans to expose for public comment separate proposed Statements on Standards for Accounting and Review Services that would provide requirements and guidance to accountants with respect to compilation engagements on pro forma or prospective financial information.

## Effective Date

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

## Objective

.06 The objective of the accountant is to prepare financial statements pursuant to a specified financial reporting framework.

## Definitions

.07 For purposes of Statements on Accounting and Review Standards (SSARSs), the following terms have the meanings attributed as follows:

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

**Financial reporting framework.** A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements (for example, accounting principles generally accepted in the United States of America [U.S. GAAP], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework).

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

**Special purpose framework.** A financial reporting framework other than GAAP that is one of the following bases of accounting:

- a. **Cash basis.** A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets).
- b. **Tax basis.** A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.
- c. **Regulatory basis.** A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject (for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission). (Ref: par. .A4)
- d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.
- e. **Other basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

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

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

## Requirements

### General Principles for Performing Engagements to Prepare Financial Statements

.08 In addition to complying with this section, an accountant is required to comply with section 60, *General Principles For Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

### Acceptance and Continuance of Client Relationships and Engagements to Prepare Financial Statements

.09 If the accountant is not satisfied with any of the matters set out in paragraph .25 of section 60 as preconditions for accepting an engagement to prepare financial statements, the accountant should discuss the matter with management or those charged with governance. If changes cannot be made to satisfy the accountant about those matters, the accountant should not accept the proposed engagement.

### Agreement on Engagement Terms

.10 The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following: (Ref: par. .A5–.A9)

- a. The objective of the engagement
- b. The responsibilities of management set forth in paragraph .25c of section 60
- c. The agreement of management that each page of the financial statements will include a statement indicating that no assurance is provided on the financial statements or the accountant will be required to issue a disclaimer that makes clear that no assurance is provided on the financial statements. (Ref: par. .A11)
- d. The responsibilities of the accountant
- e. The limitations of the engagement to prepare financial statements
- f. Identification of the applicable financial reporting framework for the preparation of financial statements
- g. Whether the financial statements are to contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure) or omit substantially all

disclosures required by the applicable financial reporting framework.

.11 The engagement letter or other suitable form of written agreement should be signed by

- a. the accountant or the accountant's firm and
- b. management or those charged with governance, as appropriate. (Ref: par. .A8)

## The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework

.12 The accountant should obtain an understanding of the financial reporting framework and the significant accounting policies intended to be used in the preparation of the financial statements. (Ref: par. .A10)

## Preparing the Financial Statements

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

.14 The accountant should ensure that a statement is included on each page of the financial statements indicating, at a minimum, that "no assurance is provided" on the financial statements. If the accountant is unable to include a statement on each page of the financial statements, the accountant should (Ref: par. .A11)

- issue either a disclaimer that makes clear that no assurance is provided on the financial statements or (Ref: par. .A12)
- perform a compilation engagement in accordance with section 80, *Compilation Engagements*

.15 When preparing financial statements in accordance with a special purpose framework, the accountant should include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements. (Ref: par. .A13)

.16 If, during the preparation of financial statements, the accountant assists management with significant judgments regarding amounts or disclosures to be reflected in the financial statements, the accountant should discuss those judgments with management so management understands the significant judgments reflected in financial statements and accepts responsibility for those judgments. (Ref: par. .A14 and .A18)

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

.18 When, after discussions with management, the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework (including inadequate disclosure), the accountant should disclose the material misstatement or misstatements in the financial statements. (Ref: par. .A15)

## Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework

**.19** When, after discussions with management, the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, the accountant should disclose such omission in the financial statements. (Ref: par. .A16)

**.20** The accountant should not prepare financial statements that omit substantially all disclosures required by the financial reporting framework if the accountant becomes aware that the omission of substantially all disclosures was undertaken with the intention of misleading users of such financial statements. (Ref: par. .A17)

## Documentation in a Preparation Engagement

**.21** The accountant should prepare documentation in connection with each preparation engagement in sufficient detail to provide a clear understanding of the work performed which, at a minimum, includes the following: (Ref: par. .A18)

- a. The engagement letter or other suitable form of written documentation with management, as described in paragraphs .10–.11
- b. A copy of the financial statements that the accountant prepared

**.22** If, in rare circumstances, the accountant judges it necessary to depart from a relevant presumptively mandatory requirement, the accountant must document the justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the intent of that requirement.

## Application and Other Explanatory Material

### Scope of This Section (Ref: par. .01–.02)

**.A1** Other historical or prospective financial information to which this section may be applied includes the following:

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

**.A2** The appendix, "Preparation of Financial Statements Versus Assistance in Preparing Financial Statements," provides examples of services that the accountant may be engaged to perform and whether this section would apply.

### The Preparation Engagement (Ref: par. .03)

**.A3** The "Nonattest Services" subtopic of the "Independence Rule" (ET sec. 1.295) addresses the accountant's considerations with respect to independence

when performing nonattest services for attest clients. For example, the accountant may prepare monthly or other interim financial statements and be engaged to perform an audit, review, or compilation engagement with respect to the annual financial statements. The accountant needs to be aware that the performance of the preparation services may impair independence unless the safeguards described in this subtopic are met.

### **Definitions (Ref: par. .07)**

**.A4** Certain regulators, including state and local government legislators, regulatory agencies, or departments, require financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all the requirements of GAAP. Such frameworks are regulatory-bases of accounting, as defined in paragraph .07. In some circumstances, however, the cash- or tax-basis of accounting may be permitted by a regulator. For purposes of this section, the cash- and tax-bases of accounting are not regulatory-bases of accounting.

### **Agreement on Engagement Terms (Ref: par. .10–.11)**

**.A5** Both management and the accountant have an interest in documenting the agreed-upon terms of the engagement to prepare financial statements before the commencement of the engagement to help avoid misunderstandings with respect to the engagement. For example, it reduces the risk that management may inappropriately rely on or may expect the accountant to protect management against certain risks or to perform certain functions, including those that are management's responsibility.

**.A6** When a third party has contracted for an engagement to prepare the entity's financial statements, agreeing the terms of the engagement with management of the entity is necessary in order to establish that the preconditions for an engagement to prepare financial statements are present.

**.A7** A contract is another suitable form of written communication. The understanding with management regarding the services to be performed for engagements to prepare financial statements is required by paragraph .10 to be in a documented form, and, accordingly, a verbal understanding is insufficient. An engagement letter is the most common, and usually the most convenient, method for documenting the understanding with management regarding the services to be performed for engagements to prepare financial statements.

**.A8** The roles of management and those charged with governance in agreeing upon the terms of the engagement to prepare financial statements for the entity depend on the governance structure of the entity and relevant law or regulation. Depending on the entity's structure, the agreement may be with management, those charged with governance, or both. Nonetheless, when the agreement on the terms of engagement is only with those charged with governance in accordance with paragraph .25c of section 60, the accountant is required to obtain management's agreement that it acknowledges and understands its responsibilities.

**.A9** An illustrative example of an engagement letter for an engagement to prepare financial statements is presented in the exhibit, "Illustrative Engagement Letter."

## The Accountant's Knowledge and Understanding of the Entity's Financial Reporting Framework (Ref: par. .12)

**.A10** The requirement that the accountant obtain an understanding of the financial reporting framework adopted by management intended to be used in the preparation of the financial statements and the significant accounting policies adopted by management does not prevent the accountant from accepting an engagement to prepare financial statements for an entity in an industry in which the accountant has no previous experience. The accountant may obtain such understanding, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, appropriate continuing professional education, or individuals who are knowledgeable about the industry.

## Preparing the Financial Statements (Ref: par. .10, .14–.16, and .18)

**.A11** The statement on each page of the financial statements, including related notes, is intended to avoid misunderstanding on the part of users with respect to the accountant's involvement with the financial statements. The statement is made at management's discretion, and the accountant or the accountant's firm name is not required to be included. The accountant is concerned that the indication is not misleading. Examples of a statement on each page of the financial statements include the following:

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

Other statements that convey that no assurance is provided on the financial statements would also be acceptable.

**.A12** An example of a disclaimer that the accountant may issue is as follows:

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 of accounting firm or accountant, as appropriate]*

*[Accountant's city and state]*

*[Date]*

**.A13** A description of the special purpose framework is usually placed next to or under the title of the financial statements (for example "statement of assets and liabilities—modified cash basis"). However, the description may be placed elsewhere in the financial statements.

**.A14** In the preparation of financial statements, the accountant may provide assistance to management with significant judgments (for example, the accountant may advise management on alternative accounting policies that are significant to the financial statements or help management with significant judgments regarding material accounting estimates).

**.A15** The disclosure of the material misstatement or misstatements may be made on the face of the financial statements or in a note to the financial statements.

**Financial Statements That Omit Substantially All the Disclosures Required by the Applicable Financial Reporting Framework (Ref: par. .19–.20)**

**.A16** The disclosure of the omission of substantially all disclosures required by the applicable financial reporting framework may be made on the face of the financial statements or in a selected note to the financial statements.

**.A17** The accountant may prepare financial statements that include disclosures about only a few matters in the notes to the financial statements. Such disclosures may be labeled "Selected Information—Substantially All Disclosures Required by [*the applicable financial reporting framework*] Are Not Included."

**Documentation in a Preparation Engagement (Ref: par. .16 and .21)**

**.A18** Documentation may include documentation regarding significant consultations or significant professional judgments made throughout the engagement.



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## Appendix—Preparation of Financial Statements Versus Assistance in Preparing Financial Statements (Ref: par. .A2)

The determination about whether the accountant has been engaged to prepare financial statements or merely assist in preparing financial statements (which is a bookkeeping service that is not subject to this section) is determined based on the services the client requests the accountant to perform and requires the accountant to apply professional judgment. The following table provides examples of services that the accountant may be engaged to perform and whether section 70 would apply. The table is not intended to be all inclusive, and professional judgment would still need to be applied.

<i>Examples of Services for Which This Section Applies</i>	<i>Examples of Accountant Services for Which This Section Does Not Apply</i>
Preparation of financial statements prior to audit or review by another accountant	Preparation of financial statements when the accountant is engaged to perform an audit, review, or compilation of such financial statements
Preparation of financial statements for an entity to be presented alongside the entity's tax return	Preparation of financial statements with a tax return solely for submission to taxing authorities
Preparation of personal financial statements for presentation alongside a financial plan	Personal financial statements that are prepared for inclusion in written personal financial plans prepared by the accountant
	Financial statements prepared in conjunction with litigation services that involve pending or potential legal or regulatory proceedings
	Financial statements prepared in conjunction with business valuation services
	Maintaining depreciation schedules
	Preparing or proposing certain adjustments, such as those applicable to deferred income taxes, depreciation, or leases
Preparation of single financial statements, such as a balance sheet or income statement or financial statements with substantially all disclosures omitted	Drafting financial statement notes
Using the information in a general ledger to prepare financial statements outside of an accounting software system	Entering general ledger transactions or processing payments (general bookkeeping) in an accounting software system

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## Exhibit—Illustrative Engagement Letter (Ref: par. .A9)

The following is an example of an engagement letter for an engagement to prepare financial statements prepared in accordance with accounting principles generally accepted in the United States of America. This engagement letter is intended as an illustration that may be used in conjunction with the considerations outlined in Statements on Standards for Accounting and Review Services. The engagement letter will vary according to individual requirements and circumstances and is drafted to refer to the preparation of financial statements for a single reporting period. The accountant may seek legal advice about whether a proposed letter is suitable.

To the appropriate representative of ABC Company:<sup>1</sup>

You<sup>2</sup> have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended and the related notes to the financial statements.<sup>3, 4</sup> We are pleased to confirm our acceptance and our understanding of this engagement to prepare the financial statements of ABC Company by means of this letter.

### Our Responsibilities

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

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

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

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<sup>1</sup> The addresses and references in the engagement letter would be those that are appropriate in the circumstances of the engagement to prepare financial statements, including the relevant jurisdiction. It is important to refer to the appropriate persons. See paragraph .A8.

<sup>2</sup> Throughout this engagement letter, references to *you, we, us, management, and accountant* would be used or amended as appropriate in the circumstances.

<sup>3</sup> If the accountant is to be engaged to prepare financial statements that omit the statement of cash flows and the related notes, the sentence may be revised to read, "You have requested that we prepare the financial statements of ABC Company, which comprise the balance sheet as of December 31, 20XX, and the related statements of income and changes in stockholders' equity." The following additional sentence may then be added: "These financial statements will not include a statement of cash flows and related notes to the financial statements."

<sup>4</sup> The accountant may include other nonattest services to be performed as part of the engagement, such as income tax preparation and bookkeeping services.

**Management Responsibilities**

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

- a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of the financial statements
- b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- c. The prevention and detection of fraud
- d. To ensure that the entity complies with the laws and regulations applicable to its activities
- e. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement to prepare financial statements
- f. To provide us with:
  - i. Documentation, and other related information that is relevant to the preparation and presentation of the financial statements,
  - ii. Additional information that may be requested for the purpose of the preparation of the financial statements, and
  - iii. Unrestricted access to persons within ABC Company of whom we determine necessary to communicate.

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

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

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

**Other Relevant Information**

Our fees for these services. . . .

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

*You agree to hold us harmless and to release, indemnify, and defend us from any liability or costs, including attorney's fees, resulting from management's knowing misrepresentations to us or resulting from any actions against us by third parties relying on the financial statements described herein except for our own intentional wrongdoing.]*

**2768**      **Statements on Standards for Accounting and Review Services**

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

Sincerely yours,

\_\_\_\_\_  
*[Signature of accountant or accountant's firm]*

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
*[Signed]*

*[Name and Title]*

\_\_\_\_\_  
*[Date]*

[Revised, February 2015, to include additional required engagement letter elements.]

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