



Agenda Item 1C

EXPOSURE DRAFT

PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

Materiality in a Review of Financial Statements; Adverse Conclusions; and Special Purpose Frameworks

Revises the following sections of Statement on Standards for Accounting and Review Services (SSARS) No. 21 (as amended):

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

August XX, 2019

Comments are requested by November 15, 2019

Prepared by the AICPA Accounting and Review Services Committee for comment from persons interested in review and reporting issues. Comments should be addressed to Mike Glynn at mike.glynn@aicpa-cima.com.

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Explanatory Memorandum

Introduction

Statements on Standards for Accounting and Review Services (SSARSs) represent the standards that accountants in public practice are required to follow when performing reviews, compilations, and engagements to prepare financial statements for non-public entities. AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* provides the requirements and associated application guidance that is applicable to all engagements performed in accordance with SSARSs. The requirements and associated application guidance specific to preparation, compilation and review engagements are provided in AR-C section 70, *Preparation of Financial Statements*; 80, *Compilation Engagements*; and AR-C section 90, *Reviews of Financial Statements*, respectively.

Paragraph .06 of extant AR-C section 70 states that the objective of the accountant in a preparation engagement is to prepare financial statements pursuant to a specified financial reporting framework.

Paragraph .04 of extant AR-C section 80 states that the objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with AR-C section 80 without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Paragraph .04 of extant AR-C section 90 states that the objective of an accountant when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, primarily through the performance of inquiry and analytical procedures.

This memorandum provides background regarding why the Accounting and Review Services Committee (ARSC) is issuing this proposed SSARS, *Materiality in a Review of Financial Statements; Adverse Conclusions; and Special Purpose Frameworks*, which would amend AR-C sections 60, 70, 80, and 90.¹

The most significant aspects of this proposed SSARS are explained in the section, “Changes From Existing Standards.”

Background

The ARSC issued SSARS No. 21 in October 2014. In developing SSARS No. 21, the ARSC used AU-C section 930, *Interim Financial Information* (AICPA, Professional Standards), as a base. AU-C section 930 was clarified using International Standard on Review Engagements (ISRE)

¹ All AR-C sections can be found in AICPA *Professional Standards*.

2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, as a base, and there are no substantive differences between AU-C section 930 and ISRE 2410. ARSC had determined that it was more appropriate to converge with the corresponding limited assurance engagement guidance in the American auditing literature than with ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*.

Subsequent to the issuance of SSARS No. 21, the ARSC issued SSARS Nos. 22-24 to further clarify the requirements and guidance for preparation, compilation, and review engagements. In developing and issuing SSARS No. 24, *Omnibus Statement on Standards for Accounting and Review Services – 2018* in May 2018, which included requirements and guidance with respect to international reporting issues, the ARSC determined that further convergence with ISRE 2400 (Revised) was appropriate and in the public interest. The ARSC believes that it is important for the SSARSs literature to be as closely converged with ISRE 2400 (Revised) so as to facilitate the accountant's ability to perform and report on engagements in accordance with both sets of standards. In addition, the ARSC believes that unnecessary differences between the standards will result in confusion as to whether an engagement performed in accordance with one set of standards results in the accountant obtaining a different level of assurance than that which would have been obtained had the engagement been performed in accordance with the other set of standards.

Importance of Consistency With Certain Concepts in the Auditing Standards

While there are significant differences between an audit engagement and an engagement performed in accordance with SSARSs, there are certain concepts related to the financial statements that are consistent regardless of the level of services performed on those financial statements. The ARSC has monitored the standard setting agenda of the Auditing Standards Board including the issuance of

- Statement on Auditing Standards No. 134, *Auditor Reporting and Amendments-Addressing Disclosures in the Audit of Financial Statements* (SAS No. 134) in April 2019. SAS No. 134 significantly revised the standards for reporting on audited financial statements.
- Exposure Draft of a proposed SAS, *Amendments to the Description of the Concept of Materiality* and proposed Statement on Attestation Engagements (SSAE), *Amendments to the Description of the Concept of Materiality*. That exposure draft is available at [\[include link to SAS Materiality exposure draft\]](#).
- Exposure draft of the proposed revised AU-C section 800, *Special Considerations – Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. That exposure draft is available at [\[include link to AU-C section 800 exposure draft\]](#).

Changes From Existing Standards

The following is a summary of the proposed changes to extant AR-C sections 60, 70, 80, and 90 that the ARSC believes would be the most significant.

Proposed Revisions to AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*

The ARSC proposes to revise paragraph .07 of AR-C section 60 so that the definition of *financial statements* is consistent with the definition in Appendix - Amendments to Various Sections in SAS

No. 122, *Statements on Auditing Standards: Clarification and Recodification*, as Amended, and SAS No. 132, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* to SAS No. 134. The proposed revision to paragraph .07 of AR-C section 60 also includes the following sentence from paragraph .08 of AU-C section 800, *Special Considerations – Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*.

The requirements of the applicable financial reporting framework determine the presentation, structure, and content of the financial statements and what constitutes a complete set of financial statements

The ARSC further proposes to revise paragraph .07 of AR-C section 60 to include definitions of the terms *applicable financial reporting framework*, *general purpose financial statements*, *general purpose framework*, *special purpose financial statements*, and *special purpose framework* consistent with the definitions of those terms in *Statements on Auditing Standards*.

Proposed Revisions to AR-C section 70, *Preparation of Financial Statements*

The definitions of *applicable financial reporting framework* and *special purpose framework* are proposed to be deleted from paragraph .07 of AR-C section 70 as those terms are proposed to be defined in paragraph .07 of AR-C section 60.

Issue #1 – Requirement for the accountant to inform management for the reasons for withdrawal from a preparation engagement

ARSC proposes to revise paragraph .14 of AR-C section 70 to require the accountant to inform management of its reasons for withdrawing when the accountant intends to withdraw from the engagement because the accountant is unable to include a statement on each page of the financial statements indicating, at a minimum, that “no assurance is provided” on the financial statements. The requirement is consistent with the requirement in paragraph .16 of AR-C section 80 when the accountant withdraws from a compilation engagement. The associated application guidance from paragraphs .A22-.A23 of AR-C section 80 are proposed to be repeated as paragraphs .A21-.A22 of AR-C section 70.

Request for Comment 1

Please provide your views on the proposed requirement for the accountant to inform management of its reasons for withdrawing when the accountant withdraws from the engagement because the accountant is unable to include a statement on each page of the financial statements indicating, at a minimum, that “no assurance is provided” on the financial statements. Do you believe that the proposed application guidance is helpful and sufficient for accountants in applying the proposed requirement?

Proposed Revisions to AR-C section 80, *Compilation Engagements*

The definitions of *applicable financial reporting framework* and *special purpose framework* are proposed to be deleted from paragraph .07 of AR-C section 80 as those terms are proposed to be defined in paragraph .07 of AR-C section 60.

Additionally, with respect to reporting requirements on financial statements prepared in accordance with special purpose frameworks, the ARSC proposes to revise certain requirements and add application guidance to be consistent, where appropriate, with the requirements and guidance in the exposure draft of the proposed revised AU-C section 800. In the case of financial

statements prepared in accordance with the provisions of a contract, those revisions include requiring the accountant to

- Consider whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.
- Include a statement that the financial statements may not be suitable for another purpose in the required separate paragraph in the accountant's compilation report on financial statements prepared in accordance with a special purpose framework.

Corresponding revisions are proposed to be made to AR-C section 90.

Proposed Revisions to AR-C section 90, *Review of Financial Statements*

The definition of *applicable financial reporting framework* is proposed to be deleted from paragraph .05 of AR-C section 90 as that term is proposed to be defined in AR-C section 60.

The majority of the revisions to AR-C section 90 are to more closely converge with ISRE 2400 (Revised). The following is a summary of the proposed changes to extant AR-C section 90 that the ARSC believes would be the most significant.

Issue #2 – Definition of limited assurance

The ARSC proposes to revise paragraph .05 of AR-C section 90 to include the following definition of *limited assurance*:

Limited assurance. The level of assurance obtained at which the risk that the accountant expresses an inappropriate conclusion is greater than it is in an audit engagement but is at an acceptably low level in the circumstances of the engagement as the basis for expressing a conclusion about whether the accountant is aware of any material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework. The combination of the nature, timing, and extent of evidence gathering procedures, while limited compared to an audit engagement, is at least sufficient for the accountant to obtain a level of assurance that is meaningful to the accountant. (Ref: par. A5)

The associated proposed application guidance reads as follows:

.A5 Sufficient appropriate review evidence is required to obtain limited assurance to support the accountant's conclusion. Review evidence is cumulative in nature and is primarily obtained from the procedures performed during the course of the review.

The proposed definition is consistent with the definition in ISRE 2400 (Revised). The ARSC believes that an understanding of the concept of limited assurance will assist practitioners in designing and performing high-quality review engagements that serves the public interest.

Request for Comment 2

Please provide your views on the proposed definition of *limited assurance* and whether you believe that defining the term will assist practitioners in planning and performing high-quality review engagements. Specifically, please advise as to whether you believe that the reference to a *level of assurance that is meaningful to the accountant* is understandable and provides an appropriate

description for accountants. If not, please provide your thoughts as to how *limited assurance* should be defined.

Issue #3 – Explicit requirement for the accountant to plan and perform the review with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated

Traditionally, AR-C section 90 has not included an explicit requirement for the accountant to plan and perform the review with professional skepticism. The ARSC believes that the effectiveness of the accountant's procedures and the overall quality of the review engagement is dependent on the accountant planning and performing review procedures consistent with the concept of professional skepticism.

To operationalize the proposed requirement, the ARSC proposes to revise paragraph .05 of extant AR-C section 90 to include the following definition:

Professional skepticism. An attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatement due to fraud or error, and a critical assessment of review evidence.

Request for Comment 3

Please provide your views on the proposed explicit requirement for the accountant to plan and perform the review with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. Do you believe that the proposed application guidance is helpful and sufficient for accountants in applying the proposed requirement?

Issue #4 – Explicit requirement for the accountant to determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures

While extant AR-C section 90 does not include an explicit requirement for the accountant to determine materiality and apply such materiality in designing procedures and evaluating results, as stated in paragraph .04 of extant AR-C section 90 the accountant's objective when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any *material* modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. As such, without a determination of materiality, the accountant is unable to meet the objective of the review engagement. For example, the accountant is required to consider materiality when,

- in accordance with paragraph .17 of extant AR-C section 90, designing and performing analytical procedures and making inquiries and performing other procedures, as appropriate, to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework.

- in accordance with paragraph .28 of extant AR-C section 90, evaluating whether uncorrected misstatements, including inadequate disclosure, identified by the practitioner in performing the review procedures or brought to the accountant's attention during the performance of the review are, individually and in the aggregate, material to the financial statements in order to determine whether any modifications should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

Additionally, in obtaining sufficient appropriate review evidence as a basis for the accountant's conclusion on the financial statements, the ARSC proposes that the accountant be required to design and perform analytical procedures and inquires to address all material items in the financial statements, including disclosures. This is in addition to the requirement in paragraph .18 of extant AR-C section 90 for the accountant to focus analytical procedures and inquiries on areas where the accountant believes that there are increased risks of material misstatements.

The revisions to AR-C section 90 do not create any inconsistencies with the exposure draft of a proposed SAS, *Amendments to the Description of the Concept of Materiality* and SSAE, *Amendments to the Description of the Concept of Materiality*.

Request for Comment 4

Please provide your views on the proposed explicit requirement for the accountant to determine materiality for the financial statements as a whole and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures. Do you believe that the proposed application guidance is helpful and sufficient for accountants in applying the proposed requirement?

Additionally, please provide your views on the proposed requirement for the accountant to design and perform analytical procedures and inquires to address all material items in the financial statements, including disclosures.

Issue #5 – Requirement for the accountant to inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about:

- a. material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures.*
- b. material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration.*

The proposed required inquiries would be in addition to the inquiries required by paragraph .22 of extant AR-C section 90.

Request for Comment 5

Please provide your views on the proposed additional required inquiries of members of management who have responsibility for financial and accounting matters concerning the financial statements.

Issue #6 – Requirement for the accountant, during the review, to remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the accountant. If the accountant identifies significant transactions outside the entity’s normal course of business in the course of performing the review, the accountant should inquire of management about:

- (a) The nature of those transactions; and
- (b) Whether related parties could be involved

Request for Comment 6

Please provide your views on the proposed additional required procedures with respect to the accountant’s consideration of related parties in a review of financial statements.

Issue #7 – Ability for the accountant to express an adverse conclusion when he or she determines or is otherwise aware, that the financial statements are materially misstated and the effects of the matter(s) are both material and pervasive to the financial statements.

The ARSC questioned whether the prohibition in extant AR-C section 90 on the accountant modifying the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework (i.e., an adverse conclusion) remains appropriate when the financial statements are materially misstated and the effects of the matter(s) are both material and pervasive to the financial statements. ISRE 2400 (Revised) permits the issuance of an adverse conclusion.

The ARSC concluded that it was not in the public interest to prohibit the expression of an adverse conclusion when the accountant is aware that the financial statements are materially and pervasively misstated. While the accountant may determine to withdraw from the engagement, if so, users of the financial statements may not then be made aware of such misstatements. Further, the ARSC considered the situation in which an accountant is engaged to perform a review in accordance with both SSARSs and ISRE 2400 (Revised) and has identified a misstatement that is material and pervasive to the financial statements. While extant SSARSs prohibit the issuance of an adverse conclusion, ISRE 2400 (Revised) would require the issuance of such a conclusion. As such, in reporting, the accountant would not be able to adhere to both sets of standards.

To operationalize the proposed ability for the accountant to issue an adverse conclusion, the ARSC proposes to include a definition of the term *pervasive* in paragraph .05 of AR-C section 90. The ARSC proposes to define the term consistent with the definition in the auditing literature as follows:

Pervasive. A term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate review evidence. Pervasive effects on the financial statements are those that, in the accountant’s judgment

Proposed wrap document for Materiality/Adverse Conclusions ED
ARSC Meeting, May 7-8, 2019

- are not confined to specific elements, accounts or items of the financial statements;
- if so confined, represent or could represent a substantial portion of the financial statements; or
- with regard to disclosures, are fundamental to users' understanding of the financial statements.

The exposure draft of proposed Statements on Standards for Attestation Engagements, *Revisions to Statement on Standards for Attestation Engagements No. 18: Attestation Standards: Clarification and Recodification* includes a proposal permitting a practitioner performing a review engagement on subject matter other than historical financial statements in accordance with AT-C section 210, *Review Engagements* to be permitted to issue a report containing an adverse conclusion. The proposal to permit an adverse conclusion in an engagement performed in accordance with AT-C section 210 is based on the same reasons as such a report would be permitted for an engagement performed in accordance with AR-C section 90.

Request for Comment 7

Please provide your views on the proposal to permit the accountant to express an adverse conclusion for an engagement performed in accordance with AR-C section 90 when he or she determines or is otherwise aware, that the financial statements are materially misstated and the effects of the matter(s) are both material and pervasive to the financial statements.

Also, please provide your views regarding whether the reasons to permit an adverse conclusion in accordance with AR-C section 90 are consistent with the reasons to permit an adverse conclusion in accordance with AT-C section 210.

Issue #8 – Requirement for the accountant to document information that the accountant identified that is inconsistent with the accountant's findings regarding significant matters affecting the financial statements and how the inconsistency was addressed.

The proposed documentation requirement would be in addition to the requirement in paragraph .94c of extant AR-C section 90 that the accountant prepare review documentation that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand significant findings or issues arising during the review, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Request for Comment 8

Please provide your views on the proposed additional required documentation in a review of financial statements.

Issue #9 – Proposed effective date.

If issued as final, the ARSC proposes that the revised AR-C sections would be effective for engagements performed in accordance with SSARSs for periods ending on or after July 15, 2021.² Early implementation would be permitted.

The proposed effective date is consistent with the proposed effective date of the revised attestation standards except that the proposed attestation standards would preclude early implementation. The result would be that a practitioner could issue an adverse conclusion on a review performed in accordance with AT-C section 210 as soon as the proposed SSARS is issued.

Request for Comment 9

Are respondents supportive of the proposed effective date? If you are not supportive, please provide reasons for your response.

Guide for Respondents

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ARSC to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA for one year, beginning November 15, 2019. Responses should be sent to Mike Glynn at mike.glynn@aicpa-cima.com and received by November 15, 2019.

Comment Period

The comment period for this exposure draft ends November 15, 2019.

² This proposed effective date is provisional but will not be earlier than July 15, 2021.

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