AICPA

# Guide

## Preparation, Compilation, and Review Engagements

June 1, 2018

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# Preface

**(Updated as of June 1, 2018)**

## About AICPA Guides

This AICPA Guide is issued under the authority of the AICPA Accounting and Review Services Committee (ARSC) to assist accountants in performing preparation, compilation, and review engagements of financial statements in accordance with the Statements on Standards for Accounting and Review Services (SSARSs). ARSC is the senior committee of the AICPA that is designated by Council to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a nonpublic entity. The "Compliance With Standards Rule" of the AICPA *Code of Professional Conduct* (ET sec. 1.310.001)[1] requires a member who performs compilation, review, or other professional services addressed by SSARSs to comply with standards promulgated by ARSC.

AICPA Guides may include sections at the end of individual chapters or following the last chapter. These sections will be entitled either "Supplement" or "Appendix."

- A supplement is a reproduction, in whole or in part, of authoritative guidance originally issued by a standard setting body (including regulatory bodies) and applicable to entities or engagements within the purview of that standard setter, independent of the authoritative status of the applicable AICPA Guide.
- An appendix is included for informational purposes and has no authoritative status. However, any preparation, compilation, or review guidance in an appendix is considered other preparation, compilation, and review guidance. In applying other preparation, compilation, or review guidance, in accordance with paragraph .19 of AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*,[2] the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. Although the accountant determines the relevance of other preparation, compilation, and review guidance, such guidance in an appendix to a guide or a guide chapter has been reviewed by the AICPA Audit and Attest Standards staff and the accountant may presume that it is appropriate.

This guide is an interpretive publication pursuant to paragraph .07 of AR-C section 60. Interpretive publications are recommendations on the application of SSARSs in specific circumstances, including engagements for entities in specialized industries. Interpretive publications are issued under the authority of ARSC only after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretative publication is consistent with SSARSs.

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[1] All ET sections can be found in AICPA *Professional Standards*.

[2] All AR-C sections can be found in AICPA *Professional Standards*.

In accordance with paragraph .18 of AR-C section 60, an accountant should consider applicable interpretive publications in the performance of his or her engagement in accordance with SSARSs. If the accountant does not apply the guidance in this interpretive publication, the accountant should document how the requirements of SSARS were complied with in the circumstances addressed by such guidance.

Conforming changes made to the guidance contained in this guide are approved by the ARSC chair (or his or her designee) and the director of AICPA Audit and Attest Standards staff. Updates made to the guidance in this guide exceeding that of conforming changes are issued after all ARSC members have been provided an opportunity to consider and comment on whether the guide is consistent with the SSARSs.

An appendix and a glossary of terms have been included in this guide to provide the reader with additional sources of information related to engagements performed in accordance with SSARSs. The additional material includes the following:

- Appendix A, "Overview of Statements on Quality Control Standards," which discusses quality control standards as required by QC section 10, *A Firm's System of Quality Control*[3]

Lastly, this guide also includes two indexes, "Index of Pronouncements and Other Technical Guidance" and "Subject Index," to assist readers in locating discussion of a specific topic within the guide.

## Recognition

**Accounting and Review Services Committee**

Mike Fleming, *Chair*
Denny Ard
Jimmy Burkes
David A. Johnson
Bruce Nunnally
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**2018 Guide Edition**

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[3] All QC sections can be found in AICPA *Professional Standards*.

 

**2015 Guide Edition**

(Updates to this edition exceeded that of conforming changes.)

Michael Brand, *Chair*
Joseph S. Beck
Jeremy Dillard
M. Aron Dunn
Mike Fleming
Janice Gray
Kelly J. Hunter

The AICPA thanks Kelly J. Hunter for his invaluable assistance in developing the 2015 edition of the guide, completely revised by the issuance of SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification* (AR-C sections).

The AICPA also acknowledges the contributions of the late Dr. Thomas A. Ratcliffe in the development of the previous editions of this guide — much of which is retained in this edition. We are forever grateful for his assistance.

## Guidance Considered in This Edition

This edition of the guide has been modified by the AICPA staff to include certain changes necessary due to the issuance of authoritative guidance since the guide was originally issued, and other revisions as deemed appropriate. Authoritative guidance issued through June 1, 2018, has been considered in the development of this edition of the guide. However, this guide does not include all preparation, compilation, review, accounting, reporting, and other requirements applicable to an entity or a particular engagement. This guide is intended to be used in conjunction with all applicable sources of authoritative guidance.

Authoritative guidance that is issued and effective on or before June 1, 2018, is incorporated directly in the text of this guide. The distinct presentation of this content is intended to aid the reader in differentiating content that may not be effective for the reader's purposes.

Authoritative guidance issued but not yet effective as of the date of the guide and not becoming effective until after December 31, 2018, is referenced in a "guidance update" box; that is, a gray shaded box that contains summary information on the guidance issued but not yet effective.

In updating this guide, all guidance issued up to and including the following was considered, but not necessarily incorporated, as determined based on applicability:

- SSARS No. 24, *Omnibus Statement on Standards for Accounting and Review Services — 2018* (AR-C sections)

Users of this guide should consider authoritative guidance issued subsequent to the authoritative guidance previously listed to determine the effect of such guidance on their preparation, compilation, and review engagements. In determining the applicability of recently issued guidance, consider the effective date of such guidance.

## References to AICPA *Professional Standards*

In citing SSARSs and their related interpretations, references use AR-C section numbers, as appropriate, within AICPA *Professional Standards* and not the original statement number.

## Applicability of Quality Control Standards

QC section 10 addresses a CPA firm's responsibilities for its system of quality control for its accounting and auditing practice. A system of quality control consists of policies that a firm establishes and maintains to provide it with reasonable assurance that the firm and its personnel comply with professional standards, as well as applicable legal and regulatory requirements. The policies also provide the firm with reasonable assurance that reports issued by the firm are appropriate in the circumstances. This section applies to all CPA firms with respect to engagements in their accounting and auditing practice.

Paragraphs .20–.21 of AR-C section 60 address the accountant's specific responsibilities regarding engagement level quality control procedures for preparation, compilation, and review engagements. Because of the importance of engagement quality, appendix A has been added to this guide. Appendix A summarizes key aspects of the quality control standard. This summarization should be read in conjunction with QC section 10 and paragraphs .20–.21 of AR-C section 60, as applicable.

## Defining Professional Responsibilities in AICPA *Professional Standards*

Pursuant to paragraph .15 of AR-C section 60, SSARSs use the following two categories of professional requirements, identified by specific terms, to describe the degree of responsibility they impose on an accountant:

- *Unconditional requirements.* The accountant must comply with an unconditional requirement in all cases in which such requirement is relevant. SSARSs use the word *must* to indicate an unconditional requirement.
- *Presumptively mandatory requirements.* The accountant must comply with a presumptively mandatory requirement in all cases in which such a requirement is relevant, except in rare circumstances. In such rare circumstances, the accountant should perform alternative procedures to achieve the intent of the requirement. The need for an accountant to depart from a relevant, presumptively mandatory requirement is expected to arise only when the requirement is for a specific procedure to be performed and, in the specific circumstances of the engagement, that procedure would be ineffective in achieving the intent of the requirement. SSARSs use the word *should* to indicate a presumptively mandatory requirement.

 

If a SSARS provides that a procedure or an action is one that the accountant should consider, the consideration of the procedure or action is presumptively required. Whether the accountant performs the procedure or action is based upon the outcome of the accountant's consideration and the accountant's professional judgment. The professional requirements of a SSARS are to be understood and applied in the context of the explanatory material that provides guidance for their application. The specific terms used to define professional requirements are not intended to apply to interpretative publications issued under the authority of ARSC because interpretative publications are not SSARSs.

## AICPA.org Website

The AICPA encourages you to visit its website at aicpa.org and the Financial Reporting Center (FRC) at www.aicpa.org/frc. The FRC supports members in the execution of high-quality financial reporting. Whether you are a financial statement preparer or a member in public practice, this center provides exclusive member-only resources for the entire financial reporting process and provides timely and relevant news, guidance, and examples relevant to accounting, preparation, compilation, and review engagements, as well as audit, attest, assurance, and advisory engagements. Certain content on the AICPA's websites referenced in this guide may be restricted to AICPA members only.

### FRF for SMEs™ Accounting Framework

Users of this guide are encouraged to consider the benefits of the AICPA's *Financial Reporting Framework for Small- and Medium-Sized Entities*. More than 20 million privately owned small- and medium-sized entities (SMEs) in the United States that are not currently required to prepare U.S. generally accepted accounting principles (GAAP)-based financial statements now have a streamlined and cost effective financial reporting framework available to them. Released in June 2013, the FRF for SMEs accounting framework is a special purpose framework which offers SMEs a reliable, relevant, and simplified financial reporting solution that addresses marketplace demands.

The AICPA's FRF for SMEs accounting framework is a less complicated and less costly system of accounting for SMEs that do not need GAAP-based financial statements. The framework is a cost-beneficial solution for owner-managers and others who need financial statements that are prepared in a consistent and reliable manner in accordance with a framework that has undergone public comment and professional scrutiny. The accounting principles composing the FRF for SMEs reporting option are intended to be the most appropriate for the preparation of SME financial statements based on the needs of the financial statement users and cost-benefit considerations. Accounting principles in the framework are responsive to the well-documented issues and concerns stakeholders currently encounter when preparing financial statements for SMEs. For more information on *Financial Reporting Framework for Small- and Medium-Sized Entities*, visit www.aicpa.org/frf-smes.

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# Chapter 1

## *Review of Financial Statements*

All shaded texts in this chapter relate to Statements on Standards for Accounting and Review Services (SSARS) No. 24, *Omnibus Statement on Standards for Accounting and Review Services — 2018*, which is effective for compilations and reviews of financial statements for periods ending on or after June 15, 2019, except for the revision to paragraph .39 of AR-C section 90, *Review of Financial Statements*,[1] which is effective upon issuance.

## Introduction

**1.01** AR-C section 90 applies when the accountant is engaged to perform a review of financial statements. When performing a review of financial statements, the accountant's objective 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. AR-C section 90 may also be applied, as necessary in the circumstances, to engagements to review other historical financial information, excluding pro forma financial information. Reviews of pro forma financial information are to be performed in accordance with AT-C section 310, *Reporting on Pro Forma Financial Information*, of Statements on Standards for Attestation Engagements No. 18, *Attestation Standards, Clarification and Recodification*.[2] Examples of other historical information that an accountant may be engaged to review include, but are not limited to, the following:

- A single financial statement
- 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
- Financial information contained in a tax return

**1.02** A review engagement is substantially less in scope than an audit engagement, the objective of which is the expression of an opinion regarding the financial statements as a whole. A review engagement does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit engagement.

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

[2] All AT-C sections can be found in AICPA *Professional Standards*.

Therefore, the accountant does not express an opinion in the accountant's review report regarding the financial statements.

## Applicability

**1.03** AR-C section 90 does not apply when the accountant is engaged to review interim financial information when

- *a.* the entity's latest annual financial statements have been audited by the accountant or a predecessor;
- *b.* the accountant either
  - i. has been engaged to audit the entity's current year financial statements or
  - ii. audited the entity's latest annual financial statements and, in situations in which it is expected that the current year financial statements will be audited, the engagement of another accountant to audit the current year financial statements is not effective prior to the beginning of the period covered by the review; and
- *c.* the entity prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

AU-C section 930, *Interim Financial Information*,[3] provides guidance for review engagements when the conditions in a–c are met. The remaining paragraphs in this section assume that AR-C section 90 applies.

**1.04** An accountant performing a review of financial statements of a U.S. entity is required to follow the review standards as promulgated by the AICPA Accounting and Review Services Committee. However, an accountant may be engaged to perform a review in accordance with both Statements on Standards for Accounting and Review Services (SSARSs) and another set of review standards, such as International Standard on Review Engagements (ISRE) 2400 (Revised), *Engagements to Review Historical Financial Statements*, issued by the International Auditing and Assurance Standards Board. In circumstances in which the accountant's review report states that the review was conducted in accordance with both SSARSs and another set of review standards, the accountant should comply with both sets of standards. An example review report in which the review was conducted in accordance with both SSARSs and ISRE 2400 (Revised) is included in paragraph 1.241.

## Consideration of Materiality in a Review Engagement

**1.05** While 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 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

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[3] All AU-C sections can be found in AICPA *Professional Standards*.

 

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 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 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.

**1.06** The accountant's consideration of materiality is made in the context of the applicable financial reporting framework. Some financial reporting frameworks discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that

- misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
- judgments about materiality are made in light of surrounding circumstances and are affected by the size or nature of a misstatement or a combination of both; and
- judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

**1.07** If present in the applicable financial reporting framework, a discussion of the concept of materiality provides a frame of reference to the accountant in determining, as required by paragraph .28 of AR-C section 90, whether there are 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. If the applicable financial reporting framework does not include a discussion of the concept of materiality, the characteristics referred to in paragraph 1.06 provide the accountant with such a frame of reference.

 

**1.08** The accountant's determination of materiality is a matter of professional judgment and is affected by the accountant's perception of the needs of the financial statements' intended users. In this context, it is reasonable for the accountant to assume that users

- have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- understand that financial statements are prepared, presented, and reviewed to levels of materiality;
- recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment, and the consideration of future events; and
- make reasonable economic decisions on the basis of the information in the financial statements.

**1.09** Further, unless the review engagement is undertaken for financial statements that are intended to meet the particular needs of specific users, the possible effect of misstatements on specific users, whose information needs may vary widely, is not ordinarily considered.

**1.10** The accountant's judgment about what is material in relation to the financial statements as a whole is the same regardless of the level of assurance obtained by the accountant as a basis for expressing a conclusion on the financial statements. That is, for the same intended users, materiality for a review engagement is the same as it is for an audit engagement because materiality is based on the information needs of intended users and not the level of assurance.

**1.11** The accountant's determination of materiality for the financial statements as a whole may need to be revised during the engagement as a result of one or both of the following:

- A change in the circumstances that occurred during the review (for example, a decision to dispose of a major part of the entity's business)
- New information or a change in the accountant's understanding of the entity and its environment as a result of performing review procedures (for example, if during the review it appears actual financial results are likely to be substantially different from anticipated period-end financial results that were used initially to consider materiality for the financial statements as a whole)

# Requirements

## General Principles for Performing and Reporting on Review Engagements

**1.12** In addition to complying with AR-C section 90, an accountant is required to comply with AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*. AR-C section 60 requires

- the accountant to comply with relevant ethical requirements;

- the accountant to exercise professional judgment in the performance of the engagement;
- the accountant to perform the engagement in accordance with SSARS;
- the engagement partner to possess the competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances; and
- the engagement partner to take responsibility for certain quality control matters.

AR-C section 60 also includes certain preconditions for the performance of the engagement.

## Professional Skepticism in a Review Engagement

**1.13** Professional skepticism is an attitude that includes a questioning mind, being alert to conditions that may indicate possible misstatements due to fraud or error, and a critical assessment of review evidence. While AR-C section 90 does not include an 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, professional skepticism is necessary to the critical assessment of review evidence. This includes questioning contradictory review evidence and the reliability of responses to inquiries and other information obtained from management and those charged with governance. It also includes consideration of the sufficiency and appropriateness of review evidence obtained in light of the circumstances.

**1.14** Professional skepticism includes being alert to, for example,

- review evidence that contradicts other review evidence obtained.
- information that brings into question the reliability of responses to inquiries and other information or records to be used as review evidence.
- circumstances that suggest the need for review procedures in addition to those required by AR-C section 90.

**1.15** Maintaining professional skepticism throughout the review engagement is necessary if the accountant, for example, is to reduce the risk of

- overlooking unusual circumstances.
- overgeneralizing when drawing conclusions from review observations.
- using inappropriate assumptions in determining the nature, timing, and extent of review procedures and in evaluating the results thereof.

**1.16** The accountant may accept records and documents as genuine unless the accountant has reason to believe the contrary. The accountant neither assumes that management is dishonest nor assumes unquestioned honesty. The accountant cannot be expected to disregard past experience concerning the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the accountant of the need to maintain professional skepticism or allow the accountant to be satisfied with less than persuasive review evidence when obtaining limited assurance.

## Engagement Level Quality Control in a Review Engagement

**1.17** In a review engagement performed in accordance with SSARS, the engagement partner is required to possess the competence and capabilities to perform the engagement and competence in financial reporting, appropriate to the engagement circumstances.

**1.18** In a review engagement performed in accordance with SSARS, the engagement partner is required to take responsibility for the following:

- *a.* The overall quality of the engagement
- *b.* The direction, supervision, planning, and performance of the engagement in compliance with professional standards and applicable legal and regulatory requirements
- *c.* The accountant's report being appropriate in the circumstances
- *d.* The engagement being performed in accordance with the firm's quality control policies and procedures, including the following:
    - i. Being satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and engagements have been followed, and that conclusions reached are appropriate, including considering whether there is information that would lead the engagement partner to conclude that management lacks integrity
    - ii. Being satisfied that the engagement team collectively has the appropriate competence and capabilities to perform the engagement and expertise in financial reporting to
        - (1) perform the engagement in accordance with professional standards and applicable legal and regulatory requirements and
        - (2) enable a report that is appropriate in the circumstances to be issued, if applicable
    - iii. Taking responsibility for appropriate engagement documentation being maintained

**1.19** If the engagement partner obtains information that would have caused the firm to decline the engagement had that information been available earlier, the engagement partner is required to communicate that information promptly to the firm, so that the firm and the engagement partner can take the necessary action.

**1.20** Throughout the engagement, the engagement partner is required to remain alert, through observation and making inquiries as necessary, for evidence of noncompliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention through the firm's system of quality control or otherwise that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, is required to determine the appropriate action.

**1.21** An effective system of quality control for a firm includes a monitoring process designed to provide the firm with reasonable assurance that the firm's policies and procedures relating to the system of quality control are relevant, adequate, and operating effectively. The engagement partner is required to consider the results of the firm's monitoring process as evidenced in the latest information circulated by the firm and, if applicable, other network firms and whether deficiencies noted in that information may affect the engagement.

## Independence

**1.22** The accountant must be independent of the entity when performing a review of financial statements in accordance with SSARS. If, during the performance of the review engagement, the accountant determines that the accountant's independence is impaired, the accountant should withdraw from the review engagement. The interpretations of the "Independence Rule" (ET sec. 1.200.001)[4] of the AICPA Code of Professional Conduct provide authoritative guidance with respect to independence. In the absence of an interpretation of the "Independence Rule" that addresses a particular relationship or circumstance, a member should apply the "Conceptual Framework for Independence" interpretation (ET sec. 1.210.010).

**1.23** Although an accountant can prepare the financial statements that are the subject of the review engagement, the preparation of financial statements (in whole or in part) is a nonattest service separate from the review engagement. The preparation of financial statements is subject to the requirements of the "Nonattest Services" subtopic (ET sec. 1.295) of the "Independence Rule." When an accountant prepares financial statements for an attest client, threats to compliance with the "Independence Rule" may exist. Pursuant to paragraph .01 of the "General Requirements for Performing Nonattest Services" subtopic (ET sec. 1.295.040) of the "Independence Rule," these threats would be at an acceptable level and independence would not be impaired when all of the following safeguards are met:

- Management agrees to
  - — assume all management responsibilities as described in the "Management Responsibilities" interpretation (ET sec. 1.295.030).
  - — oversee the service by designating an individual (preferably within senior management) who possesses suitable skill, knowledge, or experience (or all of these traits). The member should assess and be satisfied that such an individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.
  - — evaluate the adequacy and results of the nonattest services performed.
  - — accept responsibility for the results of the services.
- The accountant does not assume management responsibilities when providing nonattest services and is satisfied that the entity and management will
  - — be able to meet all of the criteria listed in the aforementioned "management agrees to" section;

[4] All ET sections can be found in AICPA *Professional Standards*.

- make an informed judgment on the results of the accountant's nonattest services; and
- accept responsibility for making the significant judgments and decisions that are the proper responsibility of management.

If management is unable or unwilling to assume these responsibilities (for example, management cannot oversee the nonattest services provided or is unwilling to carry out such responsibilities due to lack of time or desire), the accountant's performance of nonattest services would impair independence.

- Before performing nonattest services, the accountant establishes and documents in writing his or her understanding with management regarding
  - objectives of the engagement,
  - services to be performed,
  - the client's acceptance of its responsibilities,
  - accountant's responsibilities, and
  - any limitations of the engagement.

**1.24** Nothing prohibits an accountant who is unable to complete a review engagement due to a determination that the accountant's independence is impaired from performing a compilation engagement on those financial statements.

## Preconditions for Accepting a Review Engagement

**1.25** In accordance with paragraph .25 of AR-C section 60 and paragraph .08 of AR-C section 90, the accountant is precluded from accepting a review engagement if

*a.* the accountant has reason to believe that relevant ethical requirements will not be satisfied;

*b.* the accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is likely to be unavailable or unreliable;

*c.* the accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement; or

*d.* management or those charged with governance impose a limitation on the scope of the accountant's work in terms of a proposed review engagement such that the accountant believes the limitation will result in the accountant being unable to perform review procedures to provide an adequate basis for issuing a review report.

**1.26** An example of when the accountant may determine that information needed to perform the review engagement is likely to be unavailable or unreliable is when financial statements or accounting records necessary to perform the review are suspected to be substantially inaccurate and incomplete.

**1.27** As a precondition for accepting a review engagement to be performed in accordance with SSARS, certain items are to be considered. In accordance with paragraph .26 of AR-C section 60 and paragraph .09 of AR-C section 90, the accountant is required to do the following:

*a.* Determine whether preliminary knowledge of the engagement circumstances indicate that ethical requirements regarding professional competence will be satisfied.

*b.* Determine whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable.

**Application to a Review of a Single Financial Statement or a Specified Element, Account, or Item of a Financial Statement**

In a review of a single financial statement or a specific element, account, or item of a financial statement, the accountant's determination about whether the financial reporting framework selected by management to be applied in the preparation of the single financial statement, account, or item of a financial statement includes consideration of whether the application of the financial reporting framework will result in a presentation that provides adequate disclosure to enable the intended users to understand the information conveyed in the financial statement or the specific element and the effect of material transactions and events on the information conveyed in the financial statement or the specific element.

**1.28** Accounting principles generally accepted in the United States of America (GAAP) and International Financial Reporting Standards (IFRS) are general purpose frameworks and are presumed to be acceptable. In determining whether the financial reporting framework selected by management to be applied in the preparation of the financial statements is acceptable, the accountant may consider whether the financial reporting framework exhibits the characteristics of suitable criteria. Suitable criteria exhibit all of the following characteristics:

- *Relevance*. Criteria are relevant to the subject matter.
- *Objectivity*. Criteria are free from bias.
- *Measurability*. Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness*. Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter.

The relative importance of each characteristic to a particular engagement is a matter of professional judgment. For example, even though a financial reporting framework designed for a special purpose may not result in the preparation of financial statements that is free from bias, that financial reporting framework may be acceptable in the circumstances.

**1.29** Additionally, the accountant's determination of the acceptability for the financial reporting framework to be applied in the preparation of financial statements would include a consideration of the nature of the entity and the intended purpose and users of the financial statements. Financial statements prepared in accordance with a special purpose framework may not be suitable for general purposes, as the users may not understand the financial reporting framework.

**1.30** Additionally, as a precondition for accepting a review engagement, in accordance with paragraph .26*c* of AR-C section 60, the accountant is required to obtain the agreement of management that it acknowledges and understands its responsibility

*a.* for the selection of the financial reporting framework to be applied in the preparation of financial statements.

*b.* for the preparation and fair presentation of financial statements in accordance with the applicable financial reporting framework and the inclusion of all informative disclosures that are appropriate for the applicable financial reporting framework used to prepare the entity's financial statements. If the financial statements are prepared in accordance with a special purpose framework, this includes

  i. a description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effect of which need not be quantified, and informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP,

  ii. a description of any significant interpretations of the contract on which the special purpose financial statements are prepared, in the case of financial statements prepared in accordance with a contractual-basis of accounting, and

  iii. additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose framework to achieve fair presentation.

*c.* for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error, unless the accountant decides to accept responsibility for such internal control.

**Practice Reminder**

Although an accountant may accept responsibility for the design, implementation, and maintenance of internal control, such an activity is a management responsibility and, as such, impairs independence if performed for an attest client. If an accountant accepts such responsibility, the accountant is precluded from performing a review of financial statements.

*d.* for preventing and detecting fraud.

*e.* for ensuring that the entity complies with laws and regulations applicable to its activities.

*f.* for the accuracy and completeness of the records, documents, explanations, and other information, including significant judgments provided by management for the preparation of financial statements.

*g.* to provide the accountant

 

i. with access to all information of which management is aware that is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters.

ii. with additional information that the accountant may request from management for the purpose of the engagement.

iii. with unrestricted access to persons within the entity of whom the accountant determines it necessary to make inquiries.

iv. at the conclusion of the engagement, with a letter that confirms certain representations made during the review.

*h.* to include the accountant's review report in any document containing financial statements that indicates that such financial statements have been reviewed by the entity's accountant, unless a different understanding is reached.

## Communications With Predecessor Accountants

**1.31** SSARS do not require a successor accountant to communicate with a predecessor accountant in connection with acceptance of a review engagement, but he or she may believe it is beneficial to obtain information that will assist in determining whether to accept the engagement. The successor accountant may consider making inquiries of the predecessor accountant when circumstances such as the following exist:

*a.* The information obtained about the prospective client and its management and principals is limited or appears to require special attention.

*b.* The change in accountants takes place substantially after the end of the accounting period for which statements are to be reviewed.

*c.* There have been frequent changes in accountants.

The predecessor accountant and the prospective client may have disagreed about accounting principles, procedures applied by the predecessor accountant, or similarly significant matters.

**1.32** Except as permitted by the AICPA Code of Professional Conduct, an accountant is precluded from disclosing any confidential information obtained in the course of an engagement unless the client specifically consents. Accordingly, if the successor accountant decides to communicate with the predecessor, it is important that the successor accountant request the client to (*a*) permit the successor accountant to make inquiries of the predecessor accountant and (*b*) authorize the predecessor accountant to respond fully to those inquiries. If the prospective client refuses to permit the predecessor accountant to respond or limits the response, the successor accountant may want to inquire about the reasons and consider the implications of that refusal in connection with acceptance of the engagement.

**1.33** When the successor accountant decides to communicate with the predecessor accountant, the inquiries may be oral or written. The inquiries are most useful if they are specific and reasonable regarding matters that will assist the successor accountant in determining whether to accept the engagement. Matters subject to inquiry would include (*a*) information that might bear on the integrity of management (owners), (*b*) disagreements with management (owners) about accounting principles or the necessity for the performance of certain procedures or similarly significant matters, (*c*) the cooperation of management (owners) in providing additional or revised information, if necessary, (*d*) the predecessor's knowledge of any fraud or illegal acts perpetrated within the client, and (*e*) the predecessor's understanding of the reason for the change of accountants.

**1.34** It is considered good practice for the predecessor accountant to respond promptly and fully to the inquiries, on the basis of known facts. However, the predecessor accountant may decide, due to unusual circumstances such as impending, threatened, or potential litigation; disciplinary proceedings; or other unusual circumstances, to not respond fully to the inquiries and instead indicate that the response is limited. A limited response may have implications in connection with acceptance of the engagement.

## Agreement on Engagement Terms

**1.35** Paragraph .11 of AR-C section 90 states that 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 between the parties that is signed by both the accountant or the accountant's firm and management or those charged with governance as appropriate.

**1.36** Such an understanding reduces the risk that the accountant or the client may misinterpret the needs or expectations of the other party. For example, it reduces the risk that management may inappropriately rely on the accountant to protect the entity against certain risks or to perform certain functions that are management's responsibility.

**1.37** The accountant should ensure that the engagement letter includes the objectives of the engagement, management's responsibilities as set forth in paragraph 1.30, the accountant's responsibilities, the limitations of the review engagement, identification of the applicable financial reporting framework for the preparation of the financial statements, and the expected form and content of the accountant's review report and a statement that there may be circumstances in which the report may differ from its expected form and content.

**Observations and Suggestions**

Obtaining an engagement letter at least annually is considered a best practice. The engagement letter can cover multiple services and address both nonattest and attest services (for example, an engagement to prepare monthly financial statements and review the annual financial statements for an entity).

**1.38** Illustrations of engagement letters for review engagements are included in paragraph 1.237.

## Understanding of the Industry

**1.39** According to paragraph .14 of AR-C section 90, to perform the review engagement, the accountant should possess or obtain an understanding of the industry in which the entity operates, including the accounting principles and practices generally used in the industry, sufficient to enable the accountant to review financial statements that are appropriate for an entity operating in that industry. Review procedures can be performed effectively only if the accountant is familiar with the industry-specific accounting principles used by the entity. For example, if the entity is a real estate developer, the accountant should be aware of the existence and application of specialized accounting methods for real estate developers. For many review engagements, the entity does not use specialized or unique accounting practices. In this case, the knowledge the accountant obtains related to accounting principles generally applicable to all entities is sufficient background to successfully execute a review.

## Knowledge of the Entity

**1.40** Pursuant to paragraph .15 of AR-C section 90, the accountant is required to obtain knowledge about the entity sufficient to identify areas in the financial statements where there is a greater likelihood that material misstatements may arise and to be able to design procedures to address those areas. The knowledge should include an understanding of (*a*) the entity's business and (*b*) the accounting principles and practices used by the entity.

**1.41** However, when the entity operates in an industry characterized by specialized accounting principles, the accountant should be familiar with that industry's specialized accounting principles, practices, and methods. If the accountant is not already knowledgeable about the industry-specific principles, he or she may obtain an understanding of such principles by referring to appropriate material. For example, the accountant may

- review relevant AICPA Audit and Accounting Guides;
- review industry publications;
- review financial statements of other entities in the same industry;
- consult with other individuals familiar with accounting practices in the industry;
- read periodicals, textbooks, and other publications that discuss financial accounting and reporting practices;
- attend seminars conducted by accounting and industry groups; and
- take continuing professional education courses on the subject matter.

**1.42** The accountant should understand the accounting principles and practices used by the entity in measuring, recognizing, recording, and disclosing all significant accounts and disclosures in the financial statements. The accountant may obtain an understanding of the accounting policies and procedures used by management through inquiry, the review of entity prepared documents, or experience with the entity.

**1.43** The accountant's understanding may include, for example, the entity's policies and procedures related to the following:

- Inventory valuation
- Fixed asset depreciation
- Revenue recognition, including whether the entity has a unique revenue recognition policy

- Estimates
- Asset impairment

**1.44** The accountant's understanding also may include matters such as changes in accounting practices and principles and differences in the entity's business model as compared with normal practices within the industry. The accountant's review procedures will be affected if unusual accounting policies and procedures come to the accountant's attention.

**1.45** The accountant's understanding of the entity's business encompasses a general understanding of the entity'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 fundamental to a successful review.

**1.46** Factors to consider in understanding the organization include the form of business organization, the entity's history, and the management structure.

**1.47** A general understanding of the entity's organization is part of the accountant's knowledge of the entity's business. Some of the factors the accountant might consider include the following:

- Form of business organization
- Principals involved in the organization
- Organizational chart
- Related party transactions

### *Form of Business Organization*

**1.48** The business may be set up as a corporation, a partnership, a sole proprietorship, or some other business form allowed by the state in which the organization is located. Knowledge of the form of business allows the accountant to anticipate how transactions, especially capital transactions, should be recorded and classified. For example, property or cash distributions may be treated as a dividend or withdrawal, depending on whether the organization is a corporation or sole proprietorship. In addition, the business form dictates the form of the equity section of the financial statements.

**1.49** In a similar fashion, whether the organization is a taxpaying entity or simply files tax returns for informational purposes may affect the financial statements. For example, for a taxpaying entity, certain transactions are required to be presented net of tax effects, but an entity that does not pay taxes (such as a partnership) would not present those transactions net of tax.

**1.50** The legal form and tax status of an entity also are important when the entity is one of several entities owned by a single investor or the same group of investors. If the accountant is reviewing the financial statements of one of several commonly owned entities, it is imperative that the concept of an accounting entity be clearly identified before financial statements are prepared. For example, the reporting entity may include all businesses owned by the same group of investors, and even though there is no equity interest among the entities, many of the practices used in accounting for consolidating entities must nonetheless be used.

 