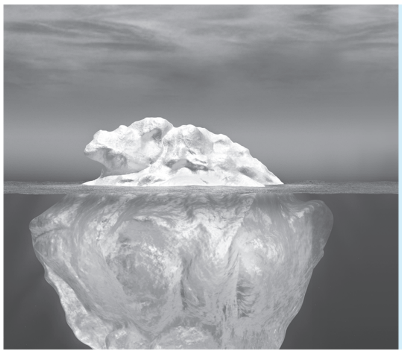

MODULE A

Other Public Accounting Services

There's no business like show business, but there are several businesses like accounting.
David Letterman, *American comedian and television host*

Professional Standards References

Topic	**AU/ISA Section***	**PCAOB Reference#**
Attestation Engagements		
Defining Professional Requirements in Statements on Standards for Attestation Engagements	AT 20	N/A
SSAE Hierarchy	AT 50	N/A
Attestation Engagements	AT 101	AT 101
Agreed-Upon Procedures Engagements	AT 201 ISAE4400	AT 201
Financial Forecasts and Projections	AT 301 ISAE4400	AT 301
Reporting on Pro Forma Financial Information	AT 401	AT 401
An Examination of an Entity's Internal Control in an Audit of Its Financial Statements	AT 501	*AS 5*
Compliance Attestation	AT 601	AT 601
Examination Engagements Regarding Compliance Reports of Brokers and Dealers	N/A	AT 1
Review Engagements Regarding Exemption Reports of Brokers and Dealers	N/A	AT 2
Management's Discussion and Analysis	AT 701	AT 701
Reporting on Controls at a Service Organization	AT 801 ISAE3402	AU 324
Reporting on Greenhouse Gas Information	ISAE 3410 *SOP 3-2*	N/A
Review and Compilation of Unaudited Financial Statements		
General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services	AR 60	N/A
Preparation of Financial Statements	AR 70	N/A
Compilation Engagements	AR 80 ISRS 4410	N/A
Review of Financial Statements	AR 90 ISRE 2400	N/A
Review of Financial Statements—Special Consideration (Exposure Draft)	AR 95	N/A
Compilation of Specified Elements, Accounts, or Items of a Financial Statement	AR 110	N/A
Compilation of Pro Forma Financial Information	AR 120	N/A
Reporting on Comparative Financial Statements	AR 200	N/A
Compilation Reports on Financial Statements Included in Certain Prescribed Forms	AR 300	N/A

Communications between Predecessor and Successor Accountants	AR 400	N/A
Personal Financial Statements	AR 600	N/A
Special Reports		
Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks	AU 800	AU 544
Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement	AU 805	AU 508 AU 623
Reporting on Compliance with Aspects of Contractual Agreements or Regulatory Requirements in Connection with Audited Financial Statements	AU 808	AU 623
Reports on Application of Requirements of an Appropriate Financial Reporting Framework	AU 915	AU 625
Other Information	AU 720	AU 550
Interim Financial Information	AU 930 ISRE 2410	AU 722

*Any unmarked references are AU/ISA. Others are as follows: *ISAE* (International Standards on Assurance Engagements), *ISRE* (International Standards for Review Engagements), *SOP* (Statements of Position—Auditing and Attestation). *ISREs* (International Standards on Review Engagements) are to be applied in the review of historical financial information. *ISAEs* (International Standards on Assurance Engagements) are to be applied in assurance engagements dealing with subject matters other than historical financial information.

#AU and AT references represent standards issued by the ASB prior to April 16, 2003, that have not been superseded or amended by the PCAOB.

LEARNING OBJECTIVES

Certified public accountants (CPAs) are trusted professionals with a reputation for objectivity and integrity. The reputation has its foundation in a long history of service to the business community and the general public. Despite recent problems (such as the Madoff scandal and the banking crisis), individuals and businesses still view their CPAs as trusted business professionals who add value to their businesses and provide valuable guidance concerning difficult business decisions. In this tradition, CPAs and other accountants offer numerous assurance and attestation services on information other than audited financial statements. These services result from consumer demand for assurance by objective experts. This module covers several areas of public accounting practice related to accountants' association with information other than audited historical financial statements discussed in Chapter 12.

This module is broken into five parts. The first part is devoted to (nonaudit) attestation engagements. The second part deals with reviews, compilations, and preparation of unaudited financial statements. The third part discusses the auditors' responsibility related to interim financial information. The fourth part addresses other topics, including special and restricted-use reports. The final part defines and further explores other type of assurance services.

Your objectives are to be able to:

- **LO A-1** Explain and provide examples of attestation engagements.
- **LO A-2** Describe reviews, compilations, and preparation of unaudited financial statements and prepare appropriate reports given specific factual circumstances.
- **LO A-3** Explain auditors' responsibilities related to reporting on interim financial information.
- **LO A-4** Define, explain, and give examples of other special reports provided by auditors, including specified elements of financial statements, special purpose frameworks, and application of requirements of appropriate financial reporting frameworks.
- **LO A-5** Explain and provide examples of assurance services engagements.

INTRODUCTION

The "green" movement is "sweeping" the world. Fueled by an increased emphasis on corporate social responsibility (CSR), companies are paying more attention to their impact on the natural world. To prove their commitment to environmental sustainability to their stakeholders, companies are voluntarily reporting on such items as carbon emissions, greenhouse gases, and other potentially detrimental effects that their operations may be generating. According to a 2015 report from the AICPA, 72% of S&P companies published sustainability reports in 2013, up from only 20% in 2011.[1] Given the public's skepticism when **BP** and other large companies report on the positive impact that they have on the environment, the public has turned to third-party assurors to verify the company's results. According to research on CSR, professional accounting firms are among the most trusted assurors of such information. Although some might question whether accountants can audit these highly technical areas, a recent *Journal of Accountancy*[2] article argues otherwise:

> CPAs are well-suited to provide assurance on sustainability reports and greenhouse gas (GHG) emissions information. They possess strong assurance methodology; experience with numerous systems, information processes, and control frameworks; the capability to identify weaknesses and other risks of misstatement; and the capability to learn new subject matters and develop new specializations.

To provide accounting professionals with guidance in these engagements, the IAASB issued ISAE 3410, "Assurance Engagements on Greenhouse Gas Statements" in June 2012; similarly, the ASB issued *SOP No. 03-2,* "Attest Engagements on Greenhouse Gas Emissions Information." This type of engagement may be a growing opportunity for professional accountants - independent research firm Verdantix projected an annual growth rate in sustainability assurance revenues of 11% from 2013-2017[3] - but it is only one of many needed services that accountants can provide to businesses beyond examining financial statements or preparing tax returns. Many of these other professional services will be discussed in this module.[4]

ATTESTATION ENGAGEMENTS

Introduction to Attestation Engagements

LO A-1

Explain and provide examples of attestation engagements.

Although the majority of this textbook is devoted to the audit of financial statements, audit services are really a subset of a larger group of services referred to as *attestation services* or simply *attest engagements.* An **attestation** is defined as an engagement

> in which a practitioner is engaged to issue or does issue an examination, a review, or an agreed-upon procedures report on subject matter, or an assertion about the subject matter … that is the responsibility of another party [AT 101.01].

The subject matter of an attest engagement may take many forms, including the following:

a. Historical or prospective performance or condition (for example, backlog data).
b. Physical characteristics (for example, narrative descriptions, square footage of facilities).
c. Historical events (for example, the price of a market basket of goods on a certain date).

[1] AICPA, "The State of Sustainability Assurance and Related Advisory Services in the U.S.: Two Market Assessments," June 2015, p. 2.

[2] Because this module discusses a wide variety of engagements, the word *accountant* is used to refer to practitioners performing nonaudit engagements rather than the word *auditor,* which has been used to this point in the text.

[3] AICPA, "The State of Sustainability Assurance and Related Advisory Services in the U.S.: Two Market Assessments," June 2015, p. 2.

[4] AICPA, "The State of Sustainability Assurance and Related Advisory Services in the U.S.: Two Market Assessments," June 2015, p. 2.

d. Analyses (for example, break-even analyses).
e. Systems and processes (for example, internal control).
f. Behavior (for example, corporate governance, compliance with laws and regulations, and human resource practices) [AT 101.07].

The subject matter of an attest engagement may be as of a point in time or for a period of time. The **responsible party** is the person at the client who is accountable for the information (e.g., the company's controller for financial information.). The accountant[5] should obtain written acknowledgment or other evidence of the party's responsibility for the subject matter or the written assertion. The responsible party can acknowledge responsibility in a number of ways, for example, in an engagement letter or a representation letter. If the accountant is not able to directly obtain written acknowledgment, the practitioner should obtain other evidence of the party's responsibility for the subject matter (for example, by reference to legislation, a regulation, or a contract).

The preceding definition of attestation identifies three types of engagements:

- An **examination** is similar in substance to an audit, but may be limited in terms of the focus of the engagement. Accountants evaluate internal controls and assess the risk of material misstatement, gather evidence in support of the assertions, and render opinions that represent a high level of assurance.
- A **review** provides only a limited level of assurance. The procedures performed in a review engagement are generally limited to making inquiries and performing analytical procedures although the accountants may decide that other procedures are necessary.
- In an **agreed-upon procedures** engagement, the client delineates exactly what procedures it wants accountants to perform. Therefore, the level of assurance provided by such an engagement varies depending on the procedures requested.

The purpose of differentiating attestation engagements from audits is to provide accountants a framework that allows them to perform other services often requested by their clients. For example, clients may want a public accounting firm to lend its name to a report on compliance with a contract or an environmental regulation. Public accounting firms have even attested to success rates at fertility clinics!

Professional standards for performing attest engagements are provided by *Statements on Standards for Attestation Engagements* (*SSAEs*) in the AT section of the AICPA's Professional Standards. *SSAE 10* lists standards similar to the fundamental auditing principles on which *Statements on Auditing Standards* (*SAS*s) are based (see Exhibit A.1 for a comparison).

Attestation standards are similar to the fundamental auditing principles; however, some important differences exist. The general standards concern the *practitioner's* knowledge about the *subject matter* of the engagement and having suitable *criteria by which to measure* the subject matter. To be suitable, the criteria must be objective, measurable, complete, and relevant. The attestation standards do not require an evaluation of internal controls although such an evaluation may be necessary, particularly in an examination engagement. In financial statement audits, the measurement criteria or **appropriate financial reporting framework** is the financial reporting framework adopted by management and, when appropriate, those charged with governance in the preparation 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. They include generally accepted accounting principles (GAAP), international financial reporting standards (IFRS), and special purpose frameworks (discussed later in this module); therefore, the determination of suitable measurement criteria has already been established.[6] In engagements in which GAAP, IFRS, or special purpose frameworks are not suitable measurement criteria, the identification of the appropriate criterion may be difficult and time-consuming. The reporting standards restrict the distribution of the reports to persons who will understand the subject matter.

[5]Because this module discusses a wide variety of engagements, the word *accountant* is used to refer to practitioners performing nonaudit engagements rather than the word *auditor*, which has been used to this point in the text.

[6]In this module, we use *GAAP* to refer to appropriate frameworks other than special purpose frameworks.

EXHIBIT A.1 Comparison of Attestation Standards and Principles

Attestation Standards	Principles
General Standards	
1. The practitioner must have adequate technical training and proficiency to perform the attest engagement.	Auditors are responsible for having appropriate competence and capabilities to perform the audit.
2. The practitioner must have adequate knowledge of the subject matter.	Not applicable
3. The practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.	Not applicable
4. The practitioner must maintain independence in mental attitude in all matters relating to the engagement.	Auditors are responsible for complying with appropriate ethical requirements.
5. The practitioner must exercise due professional care in the planning and performance of the engagement and the preparation of the report.	Auditors are responsible for maintaining professional skepticism and exercising professional judgment throughout the planning and performance of the audit.
Standards of Fieldwork	
1. The practitioner must adequately plan the work and must properly supervise any assistants.	To obtain reasonable assurance ... the auditor plans the work and properly supervises any assistants.
[Depending upon the subject matter, determination of materiality may not be required for an attestation engagement.]	To obtain reasonable assurance ... the auditor determines and applies appropriate materiality level or levels throughout the audit.
[Depending upon the subject matter, assessment of the risk of material misstatement may not be required for an attestation engagement.]	To obtain reasonable assurance ... the auditor identifies and assesses risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environment, including the entity's internal control.
2. The practitioner must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report.	To obtain reasonable assurance ... the auditor obtains sufficient appropriate evidence about whether material misstatements exist, through designing and implementing appropriate responses to the assessed risks.
Standards of Reporting	
1. The practitioner must identify the subject matter or the assertion being reported on and state the character of the engagement in the report.	The financial statements are the subject matter of audits (which are a subset of attestation engagements).
2. The practitioner must state the practitioner's conclusion about the subject matter or the assertion in relation to criteria against which the subject matter was evaluated in the report.	...the auditor expresses...an opinion...[which] states whether the financial statements are presented fairly...in accordance with the applicable financial reporting framework.
3. The practitioner must state all of the practitioner's significant reservations about the engagement, the subject matter, and if applicable, the assertion related thereto in the report.	Not applicable
4. The practitioner must state in the report that the report is intended solely for the information and use of the specified parties under the following circumstances [detail omitted].	Not applicable

Attestation engagements include those related to

- Agreed-upon procedures.
- Financial forecasts and projections.
- Pro forma financial information.
- An entity's internal control over financial reporting.
- Compliance attestation.
- Management's discussion and analysis.
- Service organizations.

We briefly discuss these types of attestation engagements in the following sections.

Applying Agreed-Upon Procedures (AT 201)

Clients sometimes engage accountants to perform specified procedures, known as *agreed-upon procedures,* to examine a particular element, account, or item in financial statements or to perform a special engagement. For example, restaurant managers may ask their accountants to classify and summarize customer comment cards, or a composer might ask an accountant to verify the mathematics on a royalty report. Such engagements should not be considered audits because the specified sets of agreed-upon procedures are usually not sufficient to be considered as audits in accordance with auditing standards. Agreed-upon procedures engagements have a limited scope, so the performance principles (assessing the risk of material misstatement and obtaining sufficient appropriate evidence for an opinion) and the reporting principle do not apply.

Under attestation standards for agreed-upon procedures engagements, accountants must reach a clear understanding with the client and the report users about the users' needs and the procedures to be performed. For these types of engagements, clearly worded engagement letters specifically delineating the desired procedures to be performed are of utmost importance. Reports are to be restricted to the specified users who participate in and take responsibility for defining the work on the engagement.

A report on an agreed-upon procedures engagement is quite different from the standard audit report. In particular, the report should identify the specified users and describe in detail the procedures the users decided were necessary; state that the work is not an audit or review that results in an overall opinion or assurance; and describe each of the agreed-upon procedures and the specific findings related to each procedure. No overall "opinion" or "negative assurance" is given as a conclusion to the report. Instead, the report provides the accountant's findings based on the procedures performed. An example agreed-upon procedures report is provided in Exhibit A.2.

Financial Forecasts and Projections (AT 301) and Pro Forma Financial Information (AT 401)

Prospective financial information is financial information representing the financial position, results of operations, and cash flows for some period of time in the future. A **financial forecast** is prospective financial information based on *expected* conditions and courses of action. A **financial projection** is prospective financial information based on the occurrence of one or more *hypothetical* events that change the entity's existing business structure (e.g., possible addition of a new distribution center, potential new product line). In contrast, **pro forma** financial information shows the effect of a proposed or consummated transaction on the *historical* financial statements "as if" that transaction had occurred by a specific date.

In many cases, the entity is negotiating directly with a single user (*limited use*) that has requested prospective financial information for use in making economic decisions (e.g., for a bank loan). Both financial projections and financial forecasts can be used for limited purposes because users directly requested the information and are aware of the nature of this information. In other instances, the entity may be preparing financial statements that it intends to present to a large number of users (*general use*), none of whom it is negotiating with at the current time. Only financial forecasts can be provided for general use because the users may not be familiar with the hypothetical event(s) underlying a financial projection.

EXHIBIT A.2 Example Agreed-Upon Procedures Report

GRABOWSKI, SPARANO & VINCELETTE

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INDEPENDENT ACCOUNTANT'S REPORT ON APPLYING AGREED-UPON PROCEDURES

Town of Ocean View
32 West Avenue
Ocean View, Delaware

We have performed the procedures enumerated below, which were agreed to by the Town of Ocean View, State of Delaware's Office of the Auditor of Accounts, Department of Homeland Security, and the Office of the State Treasurer, solely to assist the specified parties with respect to determining the Town's compliance with Delaware's applicable laws, regulations, financial reporting and the effectiveness of the internal control structure related to the municipal grant funds received for the year ended June 30, 2008. The Town of Ocean View's management is responsible for compliance with those requirements.

This agreed-upon procedures attestation engagement was performed in accordance with *Government Auditing Standards*, issued by the Comptroller General of the United States and the attestation standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested of for any other purpose.

Our procedures and findings were as follows:

1. Complete the State of Delaware Office of Auditor of Accounts municipal grants agreed-upon procedures program to determine the Town of Ocean View's compliance with applicable laws, regulations and financial reports related to municipal grant funds received for the year ended June 30, 2008, and detail any instances of noncompliance.

   The Town of Ocean View received municipal grant funds under the following programs for the year ended June 30, 2008:

   Municipal Street Aid
   Police Pension
   State Aid to Local Law Enforcement

   During the completion of the agreed-upon procedures checklists as provided by the State of Delaware Auditor of Accounts, there were no findings or recommendations relating to any of the municipal grant funds indicated above.

2. Address the status of any findings and recommendations disclosed in previous reports.

   There were no findings or recommendations relating to any municipal grant funds administered by the Town of Ocean View in previous reports.

We were not engaged to and did not conduct an examination, the objective of which would be the expression of an opinion on compliance with specified laws. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the Town of Ocean View's management and council members, the State of Delaware's Office of Auditor of Accounts, Department of Homeland Security, and the Office of the State Treasurer and should not be used by those who have not agreed to the procedures and have not taken responsibility for the sufficiency of the procedures for their purposes. However, this report is a matter of public record and its distribution is not limited.

Grabowski, Sparano
& Vincelette, CPA's

Wilmington, Delaware
January 9, 2009

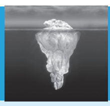
The prospective financial information may contain amounts similar to historical financial statements (single-point estimates, for example, forecast revenues of $10 million) or ranges of amounts (for example, $10 million to $14 million). If ranges are used, care should be taken to indicate that the endpoints of this range do not represent best- and worst-case scenarios. In addition, the prospective financial information should disclose the significant accounting policies and procedures used to generate the statements. If the basis in the prospective financial information is different from that used in the historical financial statements, a reconciliation of the two bases must be shown. In addition, the entity must disclose all significant assumptions used to prepare prospective financial statements, indicate that actual events or conditions may not be consistent with these assumptions, and for financial projections, indicate the limited usefulness of the projection.

To perform an attestation engagement on either prospective financial information or pro forma information, accountants must evaluate the preparation of the financial information, the support underlying the assumptions, and the presentation of the information. To accomplish these objectives, accountants must (1) obtain knowledge about the entity's business, accounting principles, and factors affecting the events and transactions in question, (2) obtain an understanding of the process through which the information was developed (e.g., determine whether all relevant information was considered in developing assumptions), (3) evaluate the assumptions (and their underlying support) used to prepare the information, (4) identify key factors affecting the information, and (5) evaluate the preparation and presentation of the financial information (e.g., consistency with AICPA guidelines).

Understanding the purposes of forecasts, projections, and pro forma engagements can be challenging. Exhibit A.3 presents a summary of the key differences between the attestation engagements discussed in this section.

EXHIBIT A.3 A Comparison of Prospective and Pro Forma Engagements

Engagement	Accountants Report on...	Example Key Question Addressed
Financial forecast	Prospective information based upon future expected conditions	What will things look like if we continue along our expected path?
Financial projection	Prospective information based upon hypothetical ("what-if?") events	What will things look like if we choose a different path(s)?
Pro forma	Financial information based on historical information "as if" the event had previously occurred	What would things look like if actual events (e.g., a merger) occurred as of December 31 instead of January 15?



AUDITING INSIGHT

Attestation Expectation Gap?

The results of an academic study indicate significant differences in beliefs among accountants, users, and preparers of prospective financial information concerning forecast reliability and the role and responsibilities of accountants and management. Contrary to the usual published studies on the expectation gap between accountants and the public, researchers found that accountants believe that forecasts are *more* reliable than users or preparers do. Accountants also believe that they have a higher level of responsibility and accountability than is attributed to them by users or preparers.

Source: P. Schelluch and G. Gay, "Assurance Provided by Auditors' Reports on Prospective Financial Information: Implications for the Expectation Gap," *Accounting and Finance,* 46 (December 2006), p. 653.

An Examination of an Entity's Internal Control over Financial Reporting That Is Integrated with an Audit of Its Financial Statements (AT 501)

Auditing Standard 5 (AS 5) requires the management of public companies to assess and report on their internal control over financial reporting and the auditors to express an opinion on the effectiveness of internal control based on established criteria (generally, based on criteria established by the Committee of Sponsoring Organizations, or COSO) in conjunction with the financial statement audits. These reports are covered in Chapter 5.

Regulators, boards, or management of *non-public* companies may engage accountants to examine and report on the effectiveness of internal controls over financial reporting in their organization in conjunction with their financial statement audit. Accountants should not accept an engagement to *review* an entity's internal control. The attestation standard (AT 501) that governs accountants' examination of an entity's internal control is very similar to *AS 5*. It calls for an examination of internal controls using a top-down, risk-based approach and control testing comparable to the approach discussed in Chapter 5. The following conditions must be met before accountants can conduct an examination on an entity's internal control:

- Management accepts responsibility for the effectiveness of its internal control.
- Management's evaluation of control is based on suitable and available criteria (e.g., COSO Report; see Chapter 5).
- Management's evaluation of control is supported by sufficient evidence.
- Management presents its assertion about the effectiveness of its internal control in a written report that accompanies the accountants' report.

Reports on examination of internal controls under AT 501 are also similar to those required by *AS 5*. A material weakness requires an adverse report. The inability to complete the engagement requires a disclaimer of opinion. A written report of significant deficiencies and material weaknesses must also be given to those charged with governance. The AICPA has proposed moving AT 501 out of the attestation standards and into the auditing standards. The proposal has received mostly positive public comments and is expected to move forward shortly.

Compliance Attestation (AT 601)

Management often must report its compliance with contractual obligations to third parties. For example, entities may have restrictive covenants in loan agreements, and lenders may require a periodic report on whether the entity has complied with these covenants. Contractual agreements could include dividend limitations, loan limitations, prescribed debt/equity ratios, or limitations on geographic operations. In addition, companies and governmental agencies must comply with applicable laws and regulations. Accountants may accept engagements to attest to (1) an entity's compliance with the requirement of the laws, regulations, rules, and so forth, and to (2) the effectiveness of an entity's internal controls that ensure compliance with the requirements. In addition to these examination engagements, accountants also can perform *agreed-upon procedures* regarding compliance. (*Reviews* of compliance are not appropriate engagements).

For a compliance attestation, three conditions must be met: (1) management accepts responsibility for compliance, (2) compliance or the controls over compliance is capable of evaluation and measurement against reasonable criteria, and (3) sufficient evidence must be available to support management's evaluation. Management may either make an assertion in a written report or as a written representation to the accountants. The accountants then *examine* or perform *agreed-upon procedures* that evaluate management's written assertion about the entity's compliance with the criteria.

Attestation standards require accountants to consider inherent risk, control risk, and detection risk in connection with *examination* engagements for compliance. These considerations are very similar to the risk elements in financial statement audits. However, consideration of materiality in compliance engagements may be difficult; sometimes monetary measures can be applied; sometimes they cannot. Nevertheless, risk and materiality are as important in compliance attestation as they are in financial statement audits.

Exercise of due care and professional skepticism about noncompliance are prerequisites for a compliance examination. Otherwise, the major steps in a compliance examination are these:

- Understand the specific compliance requirements and assess planning materiality.
- Plan the engagement and assess inherent risk.
- Understand relevant controls over compliance, assess control risk, and design tests of compliance with detection risk in mind.
- Obtain sufficient evidence of compliance with specific requirements, including a written letter of management representations.
- Consider subsequent events: subsequent information that bears on the management assertion and subsequent events of noncompliance after the assertion date.
- Form an opinion and prepare the report.

These standards call for work that is directly parallel to that in financial statement audits. The standard unmodified report in a compliance examination engagement (Exhibit A.4) expresses the accountant's opinion as to compliance. Accountants can issue an unmodified report or, if findings dictate (1) a report modified to disclose a noncompliance event, (2) a qualified report stating material noncompliance, or (3) an adverse report stating that the entity is not in compliance.

EXHIBIT A.4 Standard Unmodified Compliance Attestation Report

Independent Accountant's Report

To the Agency:

We have examined the Agency's compliance with Department of Employment Regulation JR-52 during the year ended December 31, 2014. Management is responsible for the Agency's compliance with those requirements. Our responsibility is to express an opinion on the Agency's compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about the Agency's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on the Agency's compliance with specified requirements.

In our opinion, the Agency complied, in all material respects, with the aforementioned requirements for the year ended December 31, 2014.

Smith and Smith, CPAs
February 15, 2015

Accountants may also be asked to provide similar assurance with regard to federal and state regulatory requirements. Examples include limitations on investments for mutual funds or state insurance department regulations about the nature of insurance company investments. Regulatory agencies may seek assertions in prescribed report language that go beyond acceptable professional reporting responsibilities and involve accountants in areas outside their function and responsibility. In such cases, accountants should insert additional wording in the prescribed report language or write a completely revised report that adequately reflects their position and responsibility.

Broker-Dealer Compliance (PCAOB AT1/AT2)

In 2010, in response to several high profile **broker-dealer** collapses, including Madoff Investment Securities (see Auditing Insight, Ch. 1), the *Dodd-Frank Wall Street Reform and Consumer Protection Act* gave the PCAOB the authority to oversee audits of broker-dealers. The SEC responded in 2011 with Rule 17a-5, outlining reporting, audit, and notification requirements for broker-dealers. To address the SEC's rules, the PCAOB established AT1 and AT2 to guide examinations of broker-dealer compliance with the SEC requirements.

Broker-dealers are not subject to audits of internal controls under AS5, however, broker-dealers who clear investment transactions or carry customer assets are required to file a report with the SEC addressing their compliance with net capital requirements (Rule 15c3-1), reserves and custody of securities (Rule 15c3-c), quarterly security counts (Rule 17a-13), and compliance with rules on customer statements. These compliance reports must be audited in accordance with PCAOB AT1.

AT1 requires auditors to obtain sufficient, appropriate evidence to provide reasonable assurance on the following assertions from the broker-dealer's compliance report:

- The broker-dealer was in compliance with the net capital rule and the reserve requirement rule at fiscal year-end.
- The broker-dealer had effective internal control over compliance during the year and at year-end.
- The broker-dealer based its assertions on information from its accounting records.

The AT1 engagement is an examination similar to other attestation engagements. Auditors must have adequate technical proficiency, follow ethical requirements, exercise due professional care, and have an adequate understanding of the rules relevant to broker-dealer regulations. Further, the examination should be coordinated with the audit of the financial statements and the audit procedures performed on supplemental broker-dealer information under AS17.

In planning the examination engagement, the auditor should:

- Evaluate the nature of non-compliance identified during previous examinations.
- Obtain an understanding of the entity's processes, including relevant controls, regarding compliance with financial responsibility rules, including assessing management's competence.
- Obtain an understanding of instances of non-compliance identified by management during the current fiscal year.
- Assess the risks associated with related parties.
- Read the Financial and Operational Combined Uniform Single Reports (FOCUS Report).
- Read reports of internal auditors that are relevant to the assertions.
- Inquire about regulator examinations and correspondence with the SEC that are relevant to the assertions.
- Obtain an understanding of the nature and frequency of customer complaints relevant to the assertions.
- Assess the risk of fraud, including misappropriate of customer assets, relevant to compliance.

The auditor must test both the design and operating effectiveness of the entity's Internal Control over Compliance. The procedures proscribed by AT1 to test the design and operating effectiveness of Internal Control over Compliance are similar to the requirements of AS5 (covered in Chapter 5). Similar to AS5, the evidence obtained depends upon the risk associated with the control. However, there are two primary differences: 1) The examination of Internal Control under AT1 only covers controls over compliance with the SEC regulations. The auditor of a broker-dealer is **not** required to perform a full audit of ICFR under AS5, 2) The examination of Internal Control over Compliance under AT covers controls as of fiscal year-end **and** throughout the fiscal period. The audit of ICFR under AS5 only is as of the fiscal year-end. The auditor should communicate all deficiencies identified to management.

Auditors must also perform sufficient procedures to support whether the broker-dealer was is compliance with the net capital and reserve requirements rules as of the end of the fiscal year. The tests should be planned and performed to be responsive to risks, including fraud risks, associated with non-compliance. Inquiry alone does not provide sufficient appropriate evidence. In conjunction with performing net capital and reserve requirements testing, the auditor must perform procedures to obtain evidence about the existence of customer funds or securities held for customers. Auditors must also obtain a representation letter from management and communicate with both management and the audit committee any identified instances of non-compliance with financial responsibility rules, identified Material Weaknesses, or instances where information used to determine compliance was not derived from the broker-dealer's financial records.

AUDITING INSIGHT

This isn't reassuring...

In 2012, the North American Securities Administrators Association ("NASAA") identified the top Broker-Dealer compliance violations. In an examination of 236 companies, over 450 violations were found, including nearly 150 involving the books and records of the entity. The most common violation involved maintenance of records for new customer accounts. Also included were problems with supervisory approval and customer statements/confirmations. AT1 was designed to help prevent these issues.

Source: Singer, B. "Top Broker-Dealer Compliance Issues Disclosed by State Securities Regulators." *http://www.forbes.com/sites/billsinger/2012/09/10/top-broker-dealer-compliance-issues-disclosed-by-state-securities-regulators/*

An auditor must issue an adverse opinion for any instance of noncompliance or a single material weakness in Internal Control over Compliance at any time during the fiscal year, even if the entity has completed remediation efforts. It does not matter whether the issue was discovered by the auditor or management. In that situation, the report reflects both the identification of the matter that lead to the adverse opinion, and an indication that the issue had been adequately resolved. The report should be dated no earlier than the date on which the auditor obtains sufficient appropriate evidence, but should not be earlier than the date of the auditor's report on the financial statements.

Some broker-dealers perform all their trading on their own behalf and do not hold customer funds. These entities are exempt from filing Compliance Reports, and instead file an Exemption Report. The Exemption Report is subject to a review engagement under AT2. The SEC concluded that because the importance of safeguarding customer assets was so important, some degree of assurance is required. The review standard requires auditors to obtain moderate assurance whether conditions exist that would indicate that the broker-dealer should not have claimed an exemption.

Management's Discussion and Analysis (AT 701)

Accountants also can examine or review **management's discussion and analysis** (MD&A) that usually accompanies the audited financial statements in corporate annual reports. Under existing audit standards (AU 720), auditors are required to read the MD&A section to ensure that this information accompanying the audited financial statements is consistent with them. For example, MD&A should not indicate that operating income increased by 10 percent from the prior year if this is not consistent with information in the company's audited income statement. Attestation standards allow accountants to undertake engagements to additionally *examine* or *review* the MD&A section. The performance of the attestation engagement and subsequent reporting responsibilities are similar to other attestation engagements and result in accountants issuing an opinion on the MD&A based on the engagement performed.

Service Organizations (AT 801)

Often, a **service organization** that provides services to *user entities* processes clients' transactions that are likely to be relevant to user entities' internal control over financial reporting. Examples of service organizations include payroll processing companies, computerized information processing service centers, trust departments of banks, insurers that maintain the accounting records for reinsurance transactions, mortgage bankers and savings and loan associations that service loans for owners, and transfer agents that handle the shareholder accounting for mutual and money market investment funds. The fact that management is *outsourcing* some of its noncore functions does not absolve management of its responsibility for internal control over those functions. Management (as well as the audit team) of *user entities* must somehow gain comfort that controls are in place and effective. The solution to this dilemma is a special purpose report on internal control (formerly referred to as a *SAS 70* report) in which the service organization's auditors report on the effectiveness of the service organization's internal control to the user entities (and their auditors).

There are three categories of *Service Organization Control Reports* that serve different purposes for organizations.

- *SOC 1* is the AT 801 report (illustrated in Exhibit A.5) for controls over financial reporting, now referred to as the SSAE 16 report.
- *SOC 2* report is a "report on controls at a service organization relevant to security, availability, processing integrity, confidentiality or privacy," which may be requested by a user but does not apply directly to the user's financial statements. The report contents are the same as *SOC 1* reports.
- *SOC 3* is a trust services report. It is used in marketing organizations' control effectiveness. An *SOC 3* report basically covers the same subject matter as *SOC 2* does but in less detail and in a format that lends itself to a general-use report.

Within each category, there are two types of SOC reports:

- A *type 1 report* describes the service organization's internal controls placed in operation at a specific point in time but does not report on the effectiveness of the controls.
- A *type 2 report* not only includes a description of the controls but also reports on the service organization's auditors' *testing* of the controls over a minimum six-month period.

Only the type 2 reports are useful with respect to meeting Sarbanes–Oxley's rigorous internal control requirements. Ordinarily, service auditors' reports are not public reports on internal controls but are used only by user entities' auditors to assess internal controls at the service organization.

AUDITING INSIGHT

Increase in *SSAE 16* (formerly SAS 70*)* Reports Tied to Sarbanes–Oxley

With increased outsourcing of activities that are not company core competencies, the emphasis on *SSAE 16* reports takes on greater significance. Take, for example, **Service Corporation International** (SCI), the largest provider of funeral, cemetery, and cremation services in North America. SCI's funeral homes are spread across 48 states, Canada, and Puerto Rico. The company outsources both generic activities (e.g., payroll) and some activities specific to its industry (e.g., the management of trust accounts held for future funeral and cremation services). Although it would not be cost effective for the company's management to examine the controls over all of these activities (as required by Sarbanes–Oxley), management relies on service auditors to do the work for them—the company collects more than 40 *SSAE 16* reports a year.

Source: "*SAS 70* Reports Continue to Grow in Demand and Utility for Sarbanes–Oxley Compliance," www.proviti.com, (accessed July 13, 2011).

As a condition of the engagement, management of the service organization is required to provide the auditor with a written assertion about (1) the fairness of the presentation of the description of the service organization's system, (2) the suitability of the design controls to achieve the related control objectives and, in a type 2 engagement, (3) the operating effectiveness of those controls. In a type 2 report, the service auditor expresses an opinion on the fairness of the description and on the suitability of the design and operations of the controls throughout the period covered by the report. The service auditor should inquire whether management is aware of any subsequent events that could have a significant effect on the controls at the service organization or on the service auditor's report. The service auditor also should modify the report if information comes to the service auditor's attention that causes him or her to conclude that (1) design deficiencies exist and (2) user organizations would not be expected to have controls in place to mitigate such design deficiencies.

The report in Exhibit A.5 is an example of a SOC 1 Type 2 report addressing both the design and operating effectiveness of the Service Organization's Controls.

EXHIBIT A.5 Service Auditor's SOC 1 Type 2 Report

Service Organization's Controls

Independent Service Auditor's Report on a Description of a Service Organization's System and the Suitability of the Design and Operating Effectiveness of Controls

To XYZ Service Organization:

We have examined XYZ Service Organization's description of its Global Development Center system for processing user entities' transactions throughout the year ended December 31, 2014, and the suitability of the design and operating effectiveness of controls to achieve the related control objectives stated in the description.

On page 22 of the description, XYZ Service Organization has provided an assertion about the fairness of the presentation of the description and suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description. XYZ Service Organization is responsible for preparing the description and for the assertion, including the completeness, accuracy, and method of presentation of the description and the assertion, providing the services covered by the description, specifying the control objectives and stating them in the description, identifying the risks that threaten the achievement of the control objectives, selecting the criteria, and designing, implementing, and documenting controls to achieve the related control objectives stated in the description.

Our responsibility is to express an opinion on the fairness of the presentation of the description and on the suitability of the design and operating effectiveness of the controls to achieve the related control objectives stated in the description based on our examination. We conducted our examination in accordance with attestation standards established by the American Institute of Certified Public Accountants. Those standards require that we plan and perform our examination to obtain reasonable assurance about whether, in all material respects, the description is fairly presented and the controls were suitably designed and operating effectively to achieve the related control objectives stated in the description throughout the year ended December 31, 2014.

An examination of a description of a service organization's system and the suitability of the design and operating effectiveness of the service organization's controls to achieve the related control objectives stated in the description involves performing procedures to obtain evidence about the fairness of the presentation of the description and the suitability of the design and operating effectiveness of those controls to achieve the related control objectives stated in the description. Our procedures included assessing the risks that the description is not fairly presented and that the controls were not suitably designed or operating effectively to achieve the related control objectives stated in the description. Our procedures also included testing the operating effectiveness of those controls that we consider necessary to provide reasonable assurance that the related control objectives stated in the description were achieved. An examination engagement of this type also includes evaluating the overall presentation of the description and the suitability of the control objectives stated therein, and the suitability of the criteria specified by the service organization and described at page 22. We believe that the evidence we obtained is sufficient and appropriate to provide a reasonable basis for our opinion.

Because of their nature, controls at a service organization may not prevent, or detect and correct, all errors or omissions in processing or reporting transactions. Also, the projection to the future of any evaluation of the fairness of the presentation of the description, or conclusions about the suitability of the design or operating effectiveness of the controls to achieve the related control objectives is subject to the risk that controls at a service organization may become inadequate or fail.

In our opinion, in all material respects, based on the criteria described in XYZ Service Organization's assertion on page 22.

a. the description fairly presents the system that was designed and implemented throughout the year ended December 31, 2014.
b. the controls related to the control objectives stated in the description were suitably designed to provide reasonable assurance that the control objectives would be achieved if the controls operated effectively throughout the year ended December 31, 2014.
c. the controls tested, which were those necessary to provide reasonable assurance that the control objectives stated in the description were achieved, operated effectively throughout the year ended December 31, 2014.

The specific controls tested and the nature, timing, and results of those tests are listed on pages10-20.

This report, including the description of tests of controls and results thereof on pages 10–20 is intended solely for the information and use of XYZ Service Organization, user entities of XYZ Service Organization's system during some or all of the year ended December 31, 2014, and the independent auditors of such user entities, who have a sufficient understanding to consider it, along with other information including information about controls implemented by user entities themselves when assessing the risks of material misstatements of user entities' financial statements. This report is not intended to be and should not be used by anyone other than these specified parties.

Smith and Smith CPAs
March 15, 2015
New York, NY

AUDITING INSIGHT

SOC Report Logos

Auditors and their clients can use *SOC* logos to market their services. The logos for CPAs and their clients look like this:

For CPAs who provide the services that result in a SOC 1, SOC 2 or SOC 3 report	For service organizations that had a SOC 1, SOC 2 or SOC 3 engagement within the past year

Certification mark of the AICPA, used by consent for informational purposes only.

Source: www.aicpa.org/InterestAreas/FRC/AssuranceAdvisoryServices/Pages/SOCLogosInfo.aspx. (Accessed on September 25, 2013).

This section discussed engagements and reports related to attestation services. A brief summary of these services is shown in Exhibit A.6.

EXHIBIT A.6 Summary of Attestation Reports

Services	Description	Type(s) of Engagements	Report Distribution
Agreed-upon procedures engagement	Perform procedures requested by specified users	Agreed-upon procedures	Distribution limited to users participating in determining scope of the engagement
Financial forecast	Expected conditions	Examination or agreed-upon procedures	General or limited use
Financial projections	Hypothetical conditions	Examination or agreed-upon procedures	Limited use
Pro forma	Historical statements "as if" a transaction had occurred	Examination or review	General use
Internal control	Similar to PCAOB *AS5*	Examination	General use
Compliance	Compliance or controls over compliance	Examination or agreed-upon procedures	General use for examinations
Management's discussion and analysis	Compared to rules and regulations of the SEC	Examine or review	General or limited use
Service organizations	Examine controls over financial information	Type 1—design effectiveness Type 2—operating effectiveness	Limited to user organizations and their auditors

REVIEW CHECKPOINTS

A.1 What is *attestation?* Provide some examples of attestation engagements.

A.2 What is a *responsible party?* Why is it necessary for the accountant to identify one?

A.3 What are the differences among an examination, a review, and agreed-upon procedures?

A.4 Identify several points of similarity between a compliance examination and an audit of financial statements.

A.5 What is a *service organization?* Why would it engage an auditor to report on its controls?

A.6 Why should distribution be limited for reports on projections, agreed-upon procedures, and service organizations?

UNAUDITED FINANCIAL STATEMENTS: REVIEWS, COMPILATIONS, AND PREPARATION ENGAGEMENTS

LO A-2

Describe reviews, compilations, and preparation of unaudited financial statements and prepare appropriate reports given specific factual circumstances.

Many CPAs perform bookkeeping, financial statement preparation, and other services to help nonpublic entities prepare financial communications for banks and other parties. Because these entities are not required to have an audit performed, banks and other parties may request a lower level of assurance than that provided by an audit. A subset of *attestation engagements,* these services are collectively referred to as *accounting and review services.* The Accounting and Review Services Committee (ARSC) has continuing responsibility for developing and issuing pronouncements of standards concerning the services and reports that accountants may render in connection with unaudited financial statements. This committee issues *Statements on Standards for Accounting and Review Services* (*SSARS*), which apply to accountants' services on unaudited financial statements of *nonissuers.*[7] The AICPA's Code of Professional Conduct and Statements on Quality Control Standards also govern these engagements. Accountants who perform accounting and review services should possess a level of knowledge of the accounting principles and practices of the industry. Their reports should compare financial statements to the *appropriate financial accounting framework.* All three SSARS engagements require a written engagement letter specifying the services provided.

Review Services

A review is a service performed by accountants to obtain limited assurance that no material modifications should be made to the financial statements in order for the statements to be in conformity with the applicable reporting framework (usually GAAP). Because some assurance is provided in a review engagement, accountants must be independent in order to perform review services.

Procedures performed during a review of unaudited financial statements consist primarily of obtaining **review evidence** by

1. *Obtaining* a written understanding with management about the nature and limitations of a review engagement (engagement letter).

[7]According to *SSARS,* nonissuers are all entities except those whose securities are registered under the Securities Exchange Act of 1934 or are required to file reports under the Securities Act of 1933.

2. Obtaining knowledge of the entity's business, accounting principles in the entity's industry, and the entity's organization and operations.
3. Inquiring of management about the entity's accounting system; actions taken at meetings of shareholders, directors, and other important executive committees; and issues surrounding the preparation and presentation of the financial statements, such as accounting principles used, unusual or complex transactions, significant transactions near the end of the period, subsequent events, and communications with regulatory agencies.
4. Conducting analytical procedures.
5. Reconciling the financial statements to the underlying records.
6. Obtaining written representations from management.

Professional standards require accountants to provide adequate documentation for the review engagement. Accountants are required to describe the procedures they performed and the results obtained. Although the information gained through these procedures is similar to audit evidence, they are much more limited in scope than the typical auditing procedures for assessing the risk of material misstatement, conducting physical observation of tangible assets, sending confirmations, or examining documentary details of transactions. In addition, a review does not contemplate obtaining an understanding of internal control. As a result, a review engagement does *not* provide a basis for expressing an opinion on financial statements. In a standard unmodified report for an *audit* engagement, auditors provide *positive assurance* (a forthright and factual statement of the auditors' opinion based on an audit) that the financial statements are fairly presented.

For engagements that are less than an audit, accountants instead provide *negative assurance* through a phrase such as "we are not aware of any material modifications" that are necessary for the financial statements to be in conformity with an appropriate financial reporting framework. While *auditing* standards prohibit the use of negative assurance in reports on audited financial statements (because it is considered too weak a conclusion for the audit effort), negative assurance is permitted in reviews of unaudited financial statements, in letters to underwriters, and in reviews of interim financial information. Understand that, although the assurance provided is less than in an audit engagement, the accountant should exercise professional judgment when conducting a review engagement, recognizing that circumstances may cause the financial statements to be materially misstated.

When accountants perform a review engagement, each page of the company's financial statements should be marked "See independent accountants' review report." This clearly indicates to users that an audit engagement was not performed.

Similar to an audit report, the accounting should include an emphasis-of-matter paragraph in the review report after the conclusion paragraph when it is necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that is fundamental to users' understanding (e.g., The client used a basis of accounting other than GAAP). The accountant should also include an other-matter paragraph if the accountant considers it necessary to communicate a matter other than those presented or disclosed in the financial statements. An example of a review report is provided in Exhibit A.7. Note that the review was done on financial statements prepared using a special purpose framework (tax basis) rather than GAAP.

Review Services and Fraud

SSARS require accountants to establish an understanding with the entity in an engagement letter that management is responsible for preventing and detecting fraud for all accounting and review services provided. However, for a review, the accountant has the additional responsibility to obtain written representations from management that specifically acknowledge responsibility for designing internal control to prevent and detect fraud. Further management should acknowledge disclosure to the accountant of any fraud or suspected fraud, or noncompliance with laws and regulations whose effects should be considered when preparing financial statements. In a review engagement, if the accountant becomes aware that fraud may have occurred, the accountant should communicate the matter to the appropriate level of management (at a level above those suspected of fraud). If management does not provide sufficient information that supports that the financial statements are not materially misstated due to fraud, the accountant should consider withdrawing from the engagement.

EXHIBIT A.7 Example Review Report (Income Tax Basis)

Independent Accountant's Review Report

To the Board of Directors and Shareholders of the Bluth Company:

We have reviewed the accompanying statement of assets, liability, and equity—income tax basis of the Bluth Company as of December 31, 2014, and the related statement of revenue and expenses—income tax basis for the year then ended. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with the basis of accounting the company uses for income tax purposes; this includes determining that the basis of accounting the company uses for income tax purposes is an acceptable basis for the preparation of financial statements in the circumstances. Management is also responsible for 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.

Accountants' Responsibility

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the financial statements for them to be in accordance with the basis of accounting that the company uses for income tax purposes. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in accordance with the basis of accounting the partnership uses for income tax purposes.

Basis of Accounting

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared in accordance with the basis of accounting the company uses for income tax purposes, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our conclusion is not modified with respect to this matter.

Smith and Smith, CPAs
Newport Beach, CA
March 1, 2016

Comparative Financial Statements

Review reports often are presented with comparative financial statements. Similar to an audit, when comparative financial statements are presented, the accountant's report should refer to each period for which financial statements are presented. However, because of the lower level of assurance, there are several issues that can arise in a review that are distinct from auditing.

If the accountant's report on the financial statements contains a change from a prior-period report related to a departure from the applicable financial reporting framework, the accountant's review report should include an other-matter paragraph. This additional paragraph should reference the date of the previous review report, the circumstances that cause the reference to change, and if applicable, that the financial statements of the prior period have been changed. Similarly, if the prior period was audited and the auditor's report on the prior period is not reissued, the review report should include an other-matter paragraph indicating that the financial statements of the prior period were audited, the date of the auditor's report, and the type of opinion issued.

Change from an Audit to a Review

Occasionally, a client may engage an accountant to perform an audit, but request a change to a review engagement. The client may want to make this change for a number of reasons: a creditor no longer requires an audit, the client misunderstood the difference between an audit and a review, or a scope limitation, such as inability to count inventory at year end, prevented the completion of the audit. AR-C 90 requires that the accountant should decide whether to agree to the change after considering the reason given, as well as how much additional effort and cost would be required to be able to complete the audit engagement. If the audit procedures are substantially complete, it may not be appropriate to accept the change. Generally, if the reason for the requested change is revised needs of the client or a misunderstanding about the services, a change would be acceptable. If a scope limitation led to the change, the auditor may consider the possibility that information affected by the scope limitation may be incomplete, inaccurate, or otherwise unsatisfactory. The accountant is specifically precluded from accepting a change from an audit to a review engagement, except in rare circumstances, when the scope limitation results from management's refusal to allow the accountant to correspond with the entity's legal counsel.

Other Issues Relevant to Review Engagements

1. An accountant may be engaged to review a single financial statement as long as the scope of the accountant's procedures were not restricted. Similarly, an accountant may also review specific elements or accounts of a financial statement, supplementary information (including required information), or financial information included in a tax return.
2. Sometimes an accountant will review information that is only intended or suitable for certain parties. For example, an accountant may review certain complex valuation estimates as part of a business combination. In situations where restrictions are necessary, an accountant's review report should include an alert, in a separate paragraph, restricting the use of the report when the accountant determines that the measurement or disclosure criteria are only suitable or available to certain parties.
3. When performing a review, certain analytical procedures are considered presumptively mandatory. The accountant should compare the financial statements with comparable information for the prior period. The accountant should also compare recorded amounts or ratios developed from recorded amounts to expectations developed based on an understanding of the entity and its industry, as well as comparing disaggregated revenue data. In making these comparisons, the accountant should determine the amount of difference that is acceptable without further investigation.
4. When performing a review, certain inquiries of management are also considered presumptively mandatory. These include inquires about whether the financial statements have been prepared and fairly presented in accordance with the applicable financial reporting framework, including unusual or complex situations, significant transactions, uncorrected misstatements identified during the previous review, subsequent events, knowledge of fraud or suspected fraud, noncompliance with laws and regulations, significant journal entires, related party transactions, litigation, the reasonableness of significant estimates, and actions taken at board and committee meetings. The accountant should also inquire about any other matters considered relevant.
5. Subsequent events and subsequently discovered facts in a review are treated similarly to how they are treated in an audit.
6. When supplementary information (such as Management's Discussion and Analysis) is included with the financial statements, the accountant should clearly indicate the degree of responsibility taken for the information in either an other-matter paragraph, or in a separate report. If the supplementary information is required, the other-matter paragraph should also discuss if the accountant is aware of omissions or departures from the prescribed guidelines, and whether the accountant has any unresolved doubts about whether the information is presented in accordance with guidelines.

Compilation Services

Compilation is a synonym for an older term, *write-up.* Both terms refer to accountants helping clients summarize (or "write up") their financial information in the form of financial statements. The purpose of a **compilation** engagement is to assist management in presenting financial information (including prospective financial information) that is the representation of management in the form of financial statements without providing any assurance on the accuracy or completeness of that information, but with an accountant's report attached that explicitly describes the service.

When performing a compilation engagement, the accountant has no responsibility to assess the conformity of the entity's financial statements with GAAP. However, accountants should obtain an engagement letter, understand the entity's business and applicable accounting standards, read the financial statements looking for obvious clerical or accounting principle errors, and follow up on information that is incorrect, incomplete, or otherwise unsatisfactory. Accountants are *not* required to assess control risk or to perform any other evidence-gathering procedures. Documentation should provide a clear understanding of the work performed, the engagement letter, significant findings or issues, the resolution of those issues, and any oral or written communications with management regarding fraud or illegal acts.

In a compilation engagement, given the very limited procedures performed, accountants explicitly state that no opinion and no assurance are expressed, thus taking no responsibility for a report on the fair presentation of financial statements in conformity with GAAP. Because no assurance is provided, accountants are *not* required to be independent to perform compilation engagements or issue compilation reports. However, accountants must assess whether they are independent and state in the Compilation Report if they are not.

Each page of the financial statements should be marked "See accountants' compilation report." An example report for a compilation engagement is presented in Exhibit A.8.

EXHIBIT A.8 Example Compilation Report

> Management is responsible for the accompanying financial statements of The Bluth Company, which comprise the balance sheet as of December 31, 2015 and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended, and the related notes to the financial statements in accordance with accounting principles generally accepted in the United States of America. We have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. We did not audit or review the financial statements nor were we required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, we do not express an opinion, a conclusion, nor provide any form of assurance on these financial statements.
>
> *Smith and Smith, CPAs*
> Newport Beach, CA
> March 1, 2016

Three primary types of reports on compiled financial statements can be issued:

1. The management or owners may not wish to present all footnote disclosures required by GAAP (believing such disclosures are not needed for their purposes). Accountants can issue a compilation report that notifies users of the omission and states that if they were included, they might influence users' conclusions about the business (provided the accountant has no reason to believe the footnotes were omitted to mislead the financial statement user).
2. If accountants are not independent, their report should specifically state their lack of independence. Unlike audits or reviews, accountants may provide a general description of the reason for impaired independence (e.g., providing internal control services) in their compilation report if they choose.
3. The management or owners can also choose to present the financial statements complete with all disclosures required by GAAP.

Preparation of Financial Statements

In your first principles of accounting course, you were probably given a list of account balances and accounting information and asked to prepare basic financial statements. If you had been a CPA at the time and had submitted the financial statements to a client, you may have unknowingly triggered a compilation engagement when neither you nor your client wanted a report attached to the financial statements. Many doctors, lawyers, and other small businesses want assistance from accountants with financial statements, but have no need for an accountant's report or any form of assurance.

To allow accountants to perform simple services without requiring an accountant's report, the AICPA created a new type of engagement known as Preparation of Financial Statements. When performing a Preparation of Financial Statements engagement, the accountant should prepare an engagement letter, but does not need to even assess independence. The accountant should prepare the financial statements using the client's records and should include a statement on each page of the financial statements indicating that "no assurance is provided."

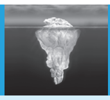
Because the accountant does not prepare a report, disclosure in the financial statements is the primary means of communicating information to users. For example, if the client uses a non-GAAP method of accounting or omits substantially all disclosures, the accountant should make sure that this is disclosed either on the face of the financial statements or in a note to the financial statements. Similarly, if the accountant becomes aware that the financial statements are incomplete, inaccurate, or otherwise unacceptable, the accountant should inform management and request additional or corrected information. However, even if management does not correct the information, the accountant need only disclose the material misstatements in the notes to the financial statements.

A preparation engagement is not performing bookkeeping for a client, nor is it many other services an accountant may perform. Exhibit A.9 outlines examples which are and are not preparation engagements.

EXHIBIT A.9 Preparation of Financial Statements Vs. Assistance in Preparing Financial Statements

Examples of Services Which are Preparation Engagements	Examples of Services Which are Not Preparation Engagements
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 to be presented alongside the entity's tax return.	Preparation of financial statements 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.

Source: *AR-C 70*



AUDITING INSIGHT

Do Plain-Paper Financial Statements Have Any Value?

A survey of practicing CPAs and bankers found that both groups reported confidence and were likely to place some reliance on plain-paper statements. This confidence was even greater when a CPA was involved with the financial statements.

Source: A. Reinstein, B. P. Green, and C. L. Miller, "Evidence of Perceived Quality of 'Plain-Paper Statements,'" *Auditing: A Journal of Practice & Theory,* November 2006, pp. 85–94.

Summary of Audits, Reviews, and Compilations

Exhibit A.10 summarizes the differences among audits, reviews, and compilations.

EXHIBIT A.10 Summary of Differences among Audits, Reviews, and Compilations

	Audit	**Review**	**Compilation**
Objective	To provide a reasonable basis for expressing an opinion regarding the financial statements taken as a whole	To provide a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with GAAP or, if applicable, special purpose framework	To present in the form of financial statements information that is the representation of the management or owners
Procedures	Audit procedures required by generally accepted auditing standards (GAAS)	Make inquiries Perform analytical procedures Obtain management representation letter	Read the financial statements and look for obvious errors
Assurance	Positive	Limited (negative)	No assurance
Independence required?	Yes	Yes	No
Professional standards	PCAOB *Auditing Standards (ASs)* and ASB *Statements on Auditing Standards (SASs)*	AICPA *Statements on Standards for Accounting and Review Services (SSARS)*	

REVIEW CHECKPOINTS

A.7 In what area(s) of practice are the Accounting and Review Service Committee pronouncements applicable?

A.8 What is the difference between a review service engagement and a compilation service engagement regarding historical financial statements? Compare both of these with an audit engagement.

Responsibilities Related to Reporting on Interim Financial Information (AU 930)

LO A-3

Explain auditors' responsibilities related to reporting on interim financial information.

Interim financial information refers to financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year-end. Entities often provide interim financial information to owners and other financial statement users or include such information in documents containing their audited annual financial statements. Companies that are under the jurisdiction of the SEC are required to engage independent accountants to review internal control over financial reporting and interim financial information filed with the SEC. In addition, when a nonissuer entity is required to file financial information with a regulatory agency in preparation for a public offering or listing, the interim information included in the filing must be reviewed. In each case, the accountants performing the review must also be engaged to perform the audit of the annual financial statements for the current year. (If they audited the financial statements in the previous year, they need only *expect* to be engaged to audit the current year.)

A review of interim financial information differs considerably from an audit. According to AU 930, the objective of a review of interim financial information is to provide the accountants a basis for communicating whether material modifications should be made to interim financial information to ensure conformity with GAAP. In this respect, the interim information review is very similar to a review of unaudited financial statements of a nonissuer. The interim review does not require a complete assessment of control risk each quarter or gathering sufficient appropriate evidential matter on which to base an opinion on interim financial information. The objective of an interim review of *internal controls* for public companies is to provide a basis for determining whether material modifications should be made to management's quarterly certifications about changes in internal control, which are required by the Sarbanes–Oxley Act.

In reviewing interim financial information, the accountants need to acquire a sufficient knowledge of the entity's business and its internal control. This information helps the accountants identify the types of potential misstatements and select the inquiries and analytical procedures that allow the accountants to communicate any modifications that must be made for the information to conform to GAAP. Basically, the extent of review procedures depends on the accountants' professional judgment about deficiencies in the internal control, the severity of unique accounting problems, and the errors that have occurred in the past. With knowledge of these areas, the accountants can direct and fine-tune the review procedures. Procedures include performing analytical procedures; reading minutes; inquiring of management and obtaining written representation about accounting issues, changes in internal controls, and the entity's ability to continue as a going concern; and reconciling the financial statements with accounting records. Procedures for reviews of internal controls include inquiring of management about significant changes in internal control, evaluating the implications of any misstatements found through other procedures that relate to internal control, and determining through observation and inquiry whether any change might materially affect internal control over financial reporting.

A written report is not required unless the entity refers to the accountant's review in writing; however, accountants may report on interim information presented separately from audited financial statements provided that a review has been satisfactorily completed. If a report is prepared, each page of the financial statements should be marked "Unaudited."

A report on reviewed interim information presented in a quarterly report (not within an annual report) is shown in Exhibit A.11.

The preceding section relates to auditors' responsibilities for interim financial information filed throughout the year with the SEC. In addition, in their Form 10-Ks, companies provide interim information for their fourth quarter as well as a summary of interim information for the entire year. This information may be presented as supplementary information accompanying audited financial statements or in a note to audited annual financial statements and should be clearly labeled "Unaudited." The auditor's report for the entity's financial statements need not refer to the reviewed information unless this information.

EXHIBIT A.11 Report on Interim Financial Statements

Independent Accountant's Report

We have reviewed the accompanying unaudited condensed balance sheets of Dunder-Mifflin Inc. as of March 31, 2015, and the related consolidated statements of income and comprehensive income for the three-month period then ended. This interim financial information is the responsibility of the company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, the objective of which is the expression of an opinion regarding the financial information taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying interim financial information for it to be in conformity with accounting principles generally accepted in the United States of America.

Michael Scarn, LLP
May 1, 2015

- Has not been marked "Unaudited" (in this case, the auditor should disclaim an opinion on the interim financial information).
- Is not in conformity with GAAP (in this case, the opinion on the audited statements is not modified but the departure is discussed in a separate paragraph).
- Is required and has been omitted.
- Has not been reviewed by the accountant.

REVIEW CHECKPOINTS

A.9 In what respects is a review of interim financial information similar to a review of the unaudited annual financial statements of a nonissuer?

A.10 Is interim financial information required to be presented by (a) U.S. GAAP and (b) SEC filing requirements?

OTHER TOPICS: SPECIAL AND RESTRICTED-USE REPORTS

LO A-4

Define, explain, and give examples of other special reports provided by auditors, including specified elements of financial statements, special purpose frameworks, and application of requirements of appropriate financial reporting frameworks.

Auditors may issue special reports in connection with the following:

- Conducting engagements to report on specified elements, accounts, or items of a financial statement.
- Reporting on accounting using a special purpose framework.
- Reporting on the requirements of appropriate financial reporting frameworks.

Specified Elements, Accounts, or Items (AU 805)

Entities may have a lender or another user request an audit of an element, account, or item within the financial statements. Auditors may be requested to render special reports on a single financial statement (e.g. balance sheet only) or such elements as rentals, royalties, profit participations, or a provision for income taxes. These engagements are different than attestation engagements in that the accountant follows the fundamental auditing principles instead of attestation standards and should consider any disclosures related to the element.

The auditor's report on a single statement or elements, accounts, or items is very similar to the standard auditor's report on the complete set of financial statements. The auditors express an opinion on whether the element, account, or item is fairly stated in accordance with GAAP. Refer to Exhibit A.12 for an illustrative report on a company's accounts receivable. If an adverse opinion or disclaimer of opinion is issued for the financial statements taken as a whole, the public accounting firm may separately report only on an element, account, or item in the financial statements if that report is *not* published with the report containing the adverse or disclaimer of opinion, and the element is not a major portion of the financial statements and is not based on stockholders' equity or net income. Auditors cannot express an unmodified opinion on a single financial statement if they expressed a disclaimer or adverse opinion on the complete set of financial statements.

Special Purpose Frameworks

Often small companies choose to report on a framework other than U.S. GAAP or IFRS, using instead **special purpose frameworks,** also known as *other comprehensive bases of accounting* or *OCBOA*. A special purpose framework in this context refers to a coherent accounting treatment in which substantially all important financial measurements are governed by criteria other than GAAP. Some examples include (1) statements conforming to regulatory agency accounting rules, (2) tax basis accounting, (3) **cash basis framework** accounting (i.e., no accruals) or **modified cash basis framework** accounting (i.e., limited accruals such as long-term assets and liabilities or inventory), and (4) some other method required for contractual purposes.

The Private Companies Practice Section (PCPS) of the AICPA Division for Firms has promoted special purpose frameworks to its members as a way to accomplish simplified reporting. The position is that special purpose framework financial statements can be less expensive to produce and easier to interpret than full GAAP statements. Surveys report that 50 percent of special purpose framework financial statements are on the tax basis of accounting and 49 percent are on the cash basis. However, PCPS also notes that special purpose frameworks are appropriate *only* when they meet user needs. Companies that are not subject to SEC regulations and filing requirements can choose to present financial information in accordance with special purpose frameworks.

AU 800 warns that special purpose framework financial statements should not use the titles normally associated with GAAP statements such as balance sheet, statement of financial position, statement of operations, income statement, statement of comprehensive income, and statement of cash flows. Even the titles are said to suggest GAAP financial statements. Instead, special purpose framework statements should use titles such as statement of assets and liabilities and statement of revenue and expenses with a designator for the basis used (regulatory, cash, income tax, etc.):

- Statement of assets and liabilities—regulatory basis.
- Statement of admitted assets, liabilities, and surplus—statutory basis required by the insurance department of the state of (name).
- Statement of income—regulatory basis.
- Statement of revenue collected and expenses paid—cash basis.
- Statement of changes in partners' capital accounts—income tax basis.

EXHIBIT A.12 Report on a Financial Element

Independent Auditor's Report

The Board of Directors and Stockholders
Dunder-Mifflin Inc.

We have audited the accompanying schedule of accounts receivable of Dunder Mifflin Inc. as of December 31, 2014, and the related notes (the schedule).

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of this schedule in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the schedule that is free from material misstatement, whether due to fraud or error.

Accountants' Responsibility

Our responsibility is to express an opinion on the schedule based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule is free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the schedule. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the schedule, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the schedule in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the schedule. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Accountant's Conclusion

In our opinion, the schedule referred to above presents fairly, in all material respects, the accounts receivable of Dunder-Mifflin Inc. as of December 31, 2014, in accordance with accounting principles generally accepted in the United States of America.

We have audited, in accordance with auditing standards generally accepted in the United States of America, the financial statements of Dunder-Mifflin Inc. as of and for the year ended December 31, 2014, and our report thereon, dated March 11, 2015, expressed an unmodified opinion on those financial statements.

Michael Scarn, LLP
Scranton, PA
March 11, 2015

Special purpose framework statements can be audited, reviewed, or compiled like any other financial statements. All auditing standards apply, and the standards for review and compilation apply just as they do for GAAP financial statements. Special purpose frameworks do not reduce disclosure requirements. The only difference introduced is that a basis of accounting different from GAAP is used in the preparation of the financial statements. The standard requires that auditors of special purpose framework statements

- Obtain an understanding of (1) the purpose for which the financial statements are prepared, (2) the intended users, and (3) the steps taken by management to determine that the special purpose framework is acceptable in the circumstances.
- Obtain the agreement of management that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the financial statements, including, but not limited to, additional disclosures beyond those required by GAAP that may be necessary to achieve fair presentation. The auditor is required to evaluate whether such disclosures are necessary.

- In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements and to evaluate whether the financial statements adequately describe such interpretations.
- When management has a choice of financial reporting frameworks in the preparation of the financial statements, explain management's responsibility for the financial statements in the auditor's report and refer to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances.
- In the case of financial statements prepared in accordance with a regulatory or contractual basis of accounting, describe in the auditor's report the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains that information.

When special purpose frameworks are audited, the auditor's report is modified as follows: (1) the introductory paragraph of the report includes a sentence that identifies the special purpose framework basis of accounting, (2) the scope paragraph is modified to "auditing standards generally accepted in the United States of America," not PCAOB standards, and (3) the opinion sentence refers to the special purpose framework instead of GAAP. Unless the financial statements are prepared under a regulatory basis for general use, the report should include an emphasis-of-matter paragraph under an appropriate heading that, among other things, states that the financial statements are prepared in accordance with a special purpose framework, which is a basis of accounting other than GAAP and refers to the note to the financial statements that describes the framework. If the special purpose framework relates to a contractual or regulatory basis of accounting, it also should be restricted to those within the entity, parties to the agreement, or a regulatory agency. If the financial statements are prepared on a regulatory basis for general use, the emphasis of a matter paragraph is not required, but the auditor should provide two opinion paragraphs, one about whether the financial statements are prepared in accordance with GAAP and another about whether the financial statements are prepared in accordance with the special purpose framework. Exhibit A.13 (AU 800) summarizes the reporting requirements.

EXHIBIT A.13 Overview of Reporting Requirements

	Cash Basis	Tax Basis	Regulatory Basis	Regulatory Basis (general use)	Contractual Basis
Opinion(s)	Single opinion on special purpose framework	Single opinion on special purpose framework	Single opinion on special purpose framework	Dual opinion on special purpose framework and generally accepted accounting principles	Single opinion on special purpose framework
Description of purpose for which special purpose financial statements are prepared	No	No	Yes	Yes	Yes
Emphasis of matter paragraph alerting readers as to the preparation in accordance with a special purpose framework	Yes	Yes	Yes	No	Yes
Other matter paragraph restricting the use of the auditor's report	No	No	Yes	No	Yes

Disclosures in the financial statements should (1) contain an explanation of the special purpose framework and (2) describe in general how the special purpose framework differs from GAAP. However, the differences between GAAP and the special purpose framework do not have to be quantified; that is, the special purpose framework does not need to be reconciled to GAAP with dollar amounts. For all practical purposes, GAAP criteria are replaced by criteria applicable to the special purpose framework. See Exhibit A.14 for an example of an auditor's report on modified cash basis statements.

EXHIBIT A.14 Special Report on Special Purpose Framework (cash basis statements)

Independent Auditor's Report

The Board of Directors and Stockholders
Apollo Shoes Inc.

Report on the Financial Statements

We have audited the accompanying financial statements of Apollo Shoes Inc., which comprise the statement of assets and liabilities arising from cash transactions as of December 31, 2014, and the related statement of revenue collected and expenses paid for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the cash basis of accounting described in Note 1; this includes determining that the cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for 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.

Accountants' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the partnership's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the partnership's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management as well as evaluating the overall presentation of the financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Accountant's Conclusion

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets and liabilities arising from cash transactions of Apollo Shoes Inc. as of December 31, 2014, and its revenue collected and expenses paid during the year then ended in accordance with the cash basis of accounting described in Note 1.

We draw attention to Note 1 of the financial statements, which describes the basis of accounting. The financial statements are prepared on the cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Smith and Smith, CPAs
Shoetown, Maine
March 1, 2015

Reports on Application of Requirements of an Appropriate Financial Reporting Framework (AU 915)

The subject of reporting on the application of requirements of an appropriate financial reporting framework touches a sensitive nerve in the public accounting profession. The issue arose from entities searching for a public accounting firm that would agree to give an unmodified audit report on a questionable accounting treatment. *Opinion shopping* often involved auditor–client disagreements, after which the client said, "If you won't agree with my accounting treatment, then I'll find an auditor who will." These disagreements often involved early revenue recognition and unwarranted expense or loss deferral. A few cases of misleading financial statements occurred after opinion shopping resulted in clients switching to more agreeable auditors. On the other hand, obtaining "second opinions" on complex accounting matters may be helpful to both clients and auditors in resolving these issues.

The auditing standards establish procedures for dealing with requests for consultation from parties other than auditors' own clients. These parties can include other companies (nonclients who are shopping), attorneys, and investment bankers. AU 915 is applicable in these situations:

- When preparing a written report or giving oral advice on specific transactions, either completed or proposed.
- When preparing a written report or giving oral advice on the type of audit opinion that might be rendered on specific financial statements.

Providing a written report on a hypothetical transaction (as opposed to a specific proposal) is prohibited. Also, the standard does not apply to conclusions about accounting requirements offered in connection with litigation support engagements or expert witness work, nor does it apply to advice given to another CPA in public practice. Nor does it apply to an accounting firm's expressions of positions in newsletters, articles, speeches, lectures, and the like, provided that the positions do not give advice on a specific transaction or apply to a specific company.

When auditors evaluate the requirements of GAAP, they are not required to issue written reports. However, a written report or oral advice that is provided to an entity regarding the requirements of an appropriate financial reporting framework should

- Describe the engagement and state that it was performed in accordance with appropriate standards.
- Identify the entity and describe the significant transactions, circumstances, and sources of information.
- Provide the conclusion about the requirements of the appropriate financial reporting framework or the type of audit report, including reasons for the conclusions, if appropriate.
- State that the entity's management is responsible for proper accounting treatments in consultation with its own auditors.
- State that any differences in facts, circumstances, or assumptions might change the conclusions.
- Include a separate paragraph that indicates (1) the report is for the sole use of specified parties, (2) the specified parties for whom the report is intended, and (3) the restriction that the information should not be used by anyone else.

The purpose of AU 915 is to impose some discipline on the process of shopping/consultation and to erect a barrier to some companies' quest for willing auditors. The reporting accountant should always consult with the continuing auditor of the entity to ascertain all the available facts relevant to forming a professional judgment.

REVIEW CHECKPOINTS

A.11 Why would a client ask a CPA to report on a financial statement element?

A.12 Regarding special purpose frameworks, (a) why do they exist and (b) can financial statements prepared using special purpose frameworks be audited?

A.13 What are some examples of special purpose framework?

A.14 How could "opinion shopping" be (a) suspect or (b) helpful?

A.15 What must a CPA do when reporting on the application of requirements of an appropriate financial reporting framework?

ASSURANCE SERVICES

Why Develop New Assurance Services?

LO A-5

Explain and provide examples of assurance services engagements.

Auditing courses focus on the role of auditors in the financial reporting process, but students should not lose sight of the fact that CPAs require sufficient revenue to cover expenses, provide profit, and provide funds for continued growth. One of the objectives of the AICPA has been to identify additional niche services that accountants might offer to enhance their value to clients, attract new clients, and improve the potential for growth as a business. Such services include tax and consulting, personal financial planning, forensic, and valuation services. One broad area of services falls under the heading of assurance services.

The AICPAs Assurance Services Executive Committee (ASEC) identified five megatrends that can affect CPAs business. Each presents opportunities to provide assurance service products, and each presents business risks:

1. *The shift from the industrial age to the knowledge age.* The current knowledge-based economy emphasizes management of intangible assets and decreases the focus on physical assets, measured largely in terms of historical cost. Market values may significantly differ from book values, hindering optimal capital allocation.
2. *Information technology.* The proliferation of tools (for example, cloud technology, file sharing, notepads, and smart phones) that make data digital, mobile, personal, and virtual, will amplify and empower collaboration. These tools should make open source innovation more open because they will enable more individuals to collaborate with one another in more ways and from more places than ever before. These tools will enhance outsourcing because they will make it much easier for a single department of any company to collaborate with another company. They will enhance supply chaining because headquarters will be able to be connected in real time with every individual employee stocking the shelves, every individual package, and every factory manufacturing the goods. The tools will enhance insourcing—having a company such as **UPS** come deep inside a retailer and manage its whole supply chain and use drivers who can interact with its warehouses and with every customer carrying a smart phone. And most obviously, they will enhance informing—the ability to manage your own knowledge supply chain.[8]
3. *Globalization.* One consequence of the globalization of capital markets is that organizations have facilities in different jurisdictions with different cultural principles, affiliations, ownership, accountability, and auditing standards. Domestic demand for international capital sources drives demand for a common language and

[8]T. L. Friedman, *The World Is Flat* (New York: Farrar, Straus & Giroux, 2005).

global consistency in accounting and auditing standards, hence, the recent focus on convergence of international auditing and accounting standards.

4. *Demands for transparency and new focus on corporate governance.* The call for more relevant information echoes externally from investors, creditors, analysts, regulatory agencies, and standards setters and internally from boards of directors and management. Regulatory bodies around the world are also facing pressure for, and consequently demanding, more granular levels of assessment.
5. *New social structures.* The final category of change involves new socioeconomic structures, such as the democratization of the capital markets, the aging population, and the increasing social pressures. Increasing social pressures have manifested themselves in a growing global focus on corporate social responsibility and sustainability whereby investors are demanding increased accountability from companies via regular responsibility or sustainability business reports and are often basing investment decisions on them.[9]

Definition: Assurance Services

Assurance services are "independent professional services that improve the quality of information, or its context, for decision makers."[10] A large group of activities can fit within this definition. In addition, although attestation and audit services are highly structured and intended to be useful for large groups of decision makers (e.g., investors, lenders), assurance services are more customized and intended to be useful to smaller, targeted groups of decision makers. In this sense, assurance services resemble consulting services.

Although there are many potential assurance services, several have been featured by the AICPA as offering potential for providing value to clients and improving the quality and transparency of information entities provide to their constituents.

eXtensible Business Reporting Language (XBRL)

The SEC has mandated financial reporting using **eXtensible Business Reporting Language (XBRL),** which provides a computer-readable identifying tag for each individual item of data. For example, "company net profit" has its own unique tag. The introduction of XBRL tags enables automated processing of business information by computer software. Computers can treat XBRL data "intelligently": They can recognize the information in an XBRL document, select it, analyze it, store it, exchange it with other computers, and present it automatically in a variety of ways for users. XBRL greatly increases the speed of handling financial data, reduces the chance of error, and permits automatic checking of information.

XBRL can handle data in different languages and prepared according to different accounting standards. It is flexible and can be adapted to meet different requirements and uses. Data can be transformed into XBRL by suitable mapping tools or can be generated in XBRL by appropriate software.

Although the SEC does not require auditor involvement with the XBRL tagged data or related controls, at some point it may be necessary for auditors to provide some degree of assurance on XBRL-coded data. Issues to be addressed will include the appropriate levels of assurance for various scenarios and the subject matter of assurance.[11] The ASEC has established the *XBRL Assurance Task Force* to develop guidance that will assist CPAs in public practice who are requested to provide assurance on XBRL-related documents, and the ASEC and the Auditing Standards Board have released *Statement of Position 09-1,* "Performing Agreed-Upon Procedures Engagements That Address the Completeness, Accuracy, or Consistency of XBRL-Tagged Data" that provides recommendations and guidance for practitioners who perform an attest engagement under AT 201 to provide assurance on XBRL reports. In addition, the Center for Audit Quality issued Alert #2009-55 "Potential Audit Firm Service Implications Raised by the SEC Final Rule on XBRL" to raise auditors level of awareness of the implications of XBRL, including potential services that may be provided.

[9]AICPA Assurance Services Executive Committee White Paper, "The Shifting Paradigm in Business Reporting and Assurance," 2008.

[10]Ibid.

[11]Ibid.

Enhanced Business Reporting

Enhanced business reporting focuses on improving business reporting by developing an internationally recognized, voluntary framework for presentation and disclosure of value drivers, nonfinancial performance measures, and qualitative information.[12] Benefits would include better allocation of capital by investors, reduced financing costs of companies and more efficient and effective regulatory processes, strengthened global competitiveness, and stability in the capital markets.

Integrated Reporting

The International Integrated Reporting Council (IIRC) was formed to "enhance and consolidate existing reporting practices to move towards a reporting framework that provides the information needed to develop the global economic model to meet the challenges of the 21st century."[13] The first <IR> standards were issued in 2013 to encourage a more complete set of reporting, including not only financial information, but also information about a wide range of factors that affect an entity's ability to create value over time.

Trust Services

Electronic commerce (or e-commerce), the sale of goods and services via the Internet, is exploding. According to the U.S. Census Bureau, U.S. e-commerce revenues represented 6.8% of all retail sales in the 1st quarter of 2015, up from 2.8% in 2006 and 5.6% in 2013.[14] Although the growth of e-commerce continues unabated, security issues, both real and perceived, have prevented many potential customers from purchasing goods and services via the Internet. Many customers and business owners distrust the Internet as a medium of conducting business. Indeed, a general lack of security is the top reason nonbuyers give for not purchasing products online and the top concern among current online buyers. Specifically, prospective buyers have expressed concerns about ascertaining whether an e-commerce company is authentic, is trustworthy (the e-tailer will do what it says it will do), and will safeguard buyers personal information. Customers also want to be reassured that they can get their products, services, and repairs on a timely basis. Despite growing familiarity with doing business on the Internet, these security issues have not diminished for potential customers.

For significant customer–supplier business relationships, company computers are often directly linked through Internet-based virtual private networks. Purchase orders for goods are made and sent via computer, and payment is made automatically through electronic funds transfer directly to the vendors bank. The primary benefit of such a relationship is an increase in the timeliness of the process; transactions that once took several weeks to complete manually (from customer purchase order generation to final payment being deposited to the suppliers bank account) now take only as long as it takes to ship and receive the goods. However, just as Internet customers are wary of purchasing online, business customers are often cautious about entering into such relationships with other businesses.

The AICPA and the Canadian Institute of Chartered Accountants developed WebTrust Services to provide assurance to the consumer on the reliability of Internet websites and SysTrust Services to focus on a companys systems as a means of increasing the reliability of business-to-business (B-to-B) computer transactions. Because these two services have a common framework to address risks and technological opportunities, the AICPA has adopted the term **trust services** to define a set of professional attestation and advisory services based on a core set of principles and criteria that addresses the risks and opportunities of IT-enabled systems and privacy programs.[15]

[12]http://www.aicpa.org/INTERESTAREAS/FRC/ACCOUNTINGFINANCIALREPORTING/ENHANCEDBUSINESSREPORTING/Pages/EnhancedBusinessReporting.aspx (accessed on July 24, 2013).

[13]The international <IR> Framework, http://integratedreporting.org/wp-content/uploads/2015/03/13-12-08-THE-INTERNATIONAL-IR-FRAMEWORK-2-1.pdf, (accessed on July 27, 2015).

[14]QUARTERLY RETAIL E-COMMERCE SALES 1ST QUARTER 2015 https://www.census.gov/retail/mrts/www/data/pdf/ec_current.pdf, (accessed on July 27, 2015).

[15]AICPA TSP 100 2015, para. 1

The ASEC Trust Information Integrity Task Force is focused on updating and maintaining the Trust Services Principles and Criteria (TSPC) and creating a framework of principles and criteria to provide assurance on the integrity of information, with new standards codified TSP 100 effective for years ending on or after December 15, 2014.

Trust Services comprise a set of professional attestation and advisory services based on a core set of principles and criteria that address the risks and opportunities of IT-enabled systems and privacy programs. Practitioners use the following principles and related criteria in the performance of trust services engagements:

- *Security.* The system is protected against unauthorized access (both physical and logical).
- *Availability.* The system is available for operation and use as committed or agreed.
- *Processing integrity.* System processing is complete, accurate, timely, and authorized.
- *Confidentiality.* Information designated as confidential is protected as committed or agreed.
- *Privacy.* Personal information is collected, used, retained, disclosed, and destroyed in conformity with the commitments in the entitys privacy notice and with criteria set forth in generally accepted privacy principles issued by the AICPA and CICA.[16]

Accountants offering **WebTrust Services** and **SysTrust Services** can issue opinions and corresponding "seals of assurance" on individual principles or a combination of the principles.

Sustainability Reporting

Sustainability (also called *corporate social responsibility*) is defined by the AICPA as "the triple-bottom-line of 1) economic viability, 2) social responsibility, and 3) environmental responsibility."[17] EY reports that 95% of the Global 250 issue sustainability reports.[18] Nearly all companies have adopted the reporting standards of the Global Reporting Initiative (GRI). The GRI G4 guidelines offer entities two options to report "in accordance" with standards. The Core option communicates the essential elements of a company's economic, environmental and social and governance performance. The Comprehensive option expands these disclosures to provide additional information about the organization's strategy, governance, ethics, and integrity.

Various assurance approaches are currently being used for sustainability reports by CPA firms, engineering firms, stakeholder panels, external review committees, and other groups. Standard setters have also developed assurance standards. The AICPA and CICA have developed *SOP 13-1* "Attest Engagements on Greenhouse Gas Emissions Information," and IFAC has adopted a similar standard, ISAE 3410. See Exhibit A.15 for an illustration of an assurance report on **Starbucks'** sustainability.

[16]http://www.aicpa.org/interestareas/businessindustryandgovernment/resources/sustainability/pages/sustainabilityfaqs.aspx, (accessed on July 24, 2013).

[17]http://www.aicpa.org/InterestAreas/InformationTechnology/Resources/SOC/TrustServices/DownloadableDocuments/TrustServicesPrinciples-TSP100.pdf

[18]http://www.ey.com/US/en/Services/Specialty-Services/Climate-Change-and-Sustainability-Services/Value-of-sustainability-reporting

EXHIBIT A.15 Starbucks Assurance Report

INDEPENDENT ASSURANCE REPORT

To the Stakeholders of Starbucks Coffee Company

We have examined the data identified below (the Data) contained within the Starbucks Coffee Company's Global Responsibility Annual Report (the Report) for the year ended September 28, 2014. Starbucks Coffee Company's management is responsible for the Data. Our responsibility is to express an opinion on the Data listed below based on our examination.

- Ethically sourced coffee purchases and purchases as a percentage of total green coffee purchased as contained in the Ethical Sourcing section on pages 3 and 15 of the Report;
- C.A.F.E. Practices coffee purchases as a percentage of total green coffee purchased as contained in the Ethical Sourcing section on page 3 of the Report;
- Fair trade certified coffee purchases as a percentage of total green coffee purchased as contained in the Ethical Sourcing section on page 3 of the Report;
- Certified organic coffee purchases as a percentage of total coffee purchased as contained in the Ethical Sourcing section on page 3 of the Report;
- Amount of commitment to investment in farmer loans represented as contained in the Ethical Sourcing section on pages 5 and 15 of the Report;

The Criteria used to evaluate the Data are contained in the sections of the Report indicated above.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants, and accordingly, included examining, on a test basis, evidence supporting the Data and performing such other procedures as we considered necessary in the circumstances. Those procedures are described in more detail in the paragraph below. We believe that our examination provides a reasonable basis for our opinion.

Our evidence-gathering procedures included, among other activities, the following:

- Testing the effectiveness of the internal reporting system used to collect and compile information on the Data which is included in the Report;
- Performing specific procedures, on a sample basis, to validate the Data, on site at Starbucks Coffee Trading Company buying operations in Lausanne, Switzerland, and Corporate headquarters in Seattle, Washington;
- Interviewing partners (employees) responsible for data collection and reporting;
- Reviewing relevant documentation, including corporate policies, management and reporting structures;
- Performing tests, on a sample basis, of documentation and systems used to collect, analyze and compile the Data that is included in the Report, and
- Confirming certain of the Data to third-party confirmations and reports.

In our opinion, the Data for the fiscal year ended September 28, 2014, is fairly presented, in all material respects, based on the Criteria indicated above.

Moss Adams, LLP
Seattle, Washington
April 21, 2015

REVIEW CHECKPOINTS

A.16 What makes CPAs qualified to perform the assurance services discussed here?

A.17 Briefly describe the two trust services in terms of those provided and of intended customers.

A.18 What is *sustainability reporting?* Why would a company choose to provide a sustainability report? Why would it pay for independent assurance?

Summary

Public accounting firms are highly regarded for their attestation services. Many forms of services, in addition to audits of historical financial statements, have arisen or have been proposed. Managers of companies often develop innovative financial presentations and want to give the public some assurance about them, so they engage independent CPAs. Regulators and other users, such as service organization users, also often rely on entities' communication of information and press regarding CPA attestation. Guided by the general attestation standards, auditing standards, and accounting and review services standards, auditors offer services and render reports in several areas.

Accountants have provided services related to unaudited financial statements for some time. Work of this nature is known in public practice as *review*, *compilation,* and *preparation of financial statements.* The differences lie in the amount of work performed and the level of assurance provided in an accountants' report. Review engagements involve less work than an audit, and reports give a limited level of assurance instead of an audit opinion. Compilation engagements merely involve reading the financial statements, which is less work than a review, and the report gives no assurance as expressed by an outright disclaimer. Preparation engagements are similar to compilations, but have no report and all pages of the financial statements are marked with a statement of no assurance.

Another type of review is that of interim financial information (e.g., quarterly financial reports). This review is technically similar to a review of unaudited financial statements, and the report on free-standing interim financial statements gives negative assurance.

Some entities have the option to prepare their statements for public use on special purpose frameworks. Auditors can audit and report on such financial statements. This option gives managers an opportunity to avoid the complications of many of the GAAP rules. Special purpose framework audits and reporting are discussed in the auditing standards under the heading of special reports. Other types of special audit reports can be given on particular elements, accounts, or items in a financial statement.

Because of the shift to the knowledge age and new developments in information technology, globalization, social structures, and demands for transparency and governance, assurance services offer new ways for CPAs to provide service to their clients by improving the quality of information, or its context, for decision makers. CPAs currently provide assurance on XBRL, enhanced business reporting, sustainability, and trustworthiness of electronic commerce. The AICPA is exploring other ways CPAs can provide value to their clients in the new business environment.

Key Terms

agreed-upon procedures The methods used in an engagement in which users participate in determining the scope of procedures performed by the accountants

appropriate financial reporting framework The financial reporting treatment (i.e. GAAP, IFRS, etc.) adopted by management and, when appropriate, those charged with governance in the preparation 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

assurance services The independent professional functions that improve the quality of information, or its context, for decision makers

attestation An accounting service resulting in a report on subject matter or an assertion about subject matter that is the responsibility of another party

cash basis framework A special purpose framework in which revenues are recognized when cash is received and expenses are incurred when cash is disbursed

compilation An accounting service in which the practitioner assists in assembling information that is the representation of management but provides no assurance

examination An attestation engagement similar in nature to an audit

eXtensible Business Reporting Language (XBRL) The communication terminology required by the Securities and Exchange Commission for companies to use to provide financial statement information that has a computer-readable identifying tag for each individual item of data

financial forecast The prospective financial information reflecting an entity's estimates of what is likely to occur in a future period

financial projection The prospective financial information reflecting a transaction or event that may occur in the future

interim financial information The financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end

management's discussion and analysis A required section of financial reports of public companies in which management analyzes the results of operations and cash flows for the periods presented

modified cash basis framework A special purpose framework that provides limited accruals for items such as fixed assets and/or inventories and long-term debt

pro forma The description of financial information reflecting historical data as if a certain transaction had occurred

responsible party The person or persons, either as individuals or representatives of the entity, responsible for the subject matter of an attestation engagement

review An engagement in which a practitioner provides limited assurance about financial information

review evidence The evidence required to provide limited assurance obtained by (1) inquiring of management, (2) conducting analytical procedures, and (3) obtaining written representations from management

service organization An organization or segment of it that provides services to user entities that are likely to be relevant to user entities' internal control as it relates to financial reporting

special purpose framework A coherent accounting framework in which substantially all important financial measurements are governed by criteria other than GAAP or IFRS

sustainability The triple-bottom-line of economic viability, social responsibility, and environmental responsibility

SysTrust Services An assurance function that reviews an entity's computer system to provide confidence to business partners and customers concerning the security, privacy, and confidentiality of information in addition to system availability and processing integrity

trust services A set of professional attestation and advisory functions based on a core set of principles and criteria that addresses the risks and opportunities of IT-enabled systems and privacy programs

WebTrust Services An assurance function designed to reduce the concerns of Internet users regarding the existence of a company and the reliability of key business information placed on its website

Multiple-Choice Questions for Practice and Review

connect All applicable questions are available with McGraw-Hill's *Connect® Accounting*

LO A-1

A.19 To perform an attestation engagement on prospective information or pro forma information, accountants must do all of the following *except*

a. Obtain knowledge about the entity's business and accounting principles.
b. Understand the internal controls used in the processes that generated the information.
c. Obtain an understanding of the process through which the information was developed.
d. Evaluate the assumptions used to prepare the information.

LO A-1

A.20 If a nonissuer wants an accountant to perform an examination of its internal controls, the accountant should follow:

a. PCAOB *AS 5,* "An Audit of Internal Control over Financial Reporting That Is Integrated with an Audit of Financial Statements."
b. AICPA AT 501, "An Examination of an Entity's Internal Control over Financial Reporting That Is Integrated with an Audit of Its Financial Statements."
c. AICPA AU 315, "Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement."
d. *FASB Concepts Statement No. 1,* "Objectives of Financial Reporting by Business Enterprises."

LO A-2

A.21 A review service engagement involving unaudited financial statements involves

a. More work than a compilation and an audit.
b. Less work than an audit but more work than a compilation.
c. Less work than a compilation but more work than an audit.
d. More work than an audit but less work than a compilation.

LO A-2

A.22 When accountants are *not* independent, which of the following reports can they nevertheless issue?

a. Compilation report.
b. Standard unmodified audit report.
c. Examination report on a forecast.
d. Examination of internal control over financial reporting.

LO A-1

A.23 For a compliance engagement, three conditions must be met. Which of the following is *not* one of the three conditions?

a. Management accepts responsibility for compliance.
b. Management's evaluation of compliance is capable of evaluation and is measured against reasonable criteria.
c. Sufficient evidence is available to support management's evaluation.
d. Management provides a report attesting to satisfactory compliance.

LO A-2

A.24 Accountants are permitted to express "negative assurance" in which of the following reports?

a. Standard unmodified audit report on financial statements.
b. Compilation report on unaudited financial statements.
c. Review report on unaudited financial statements.
d. Adverse opinion report on financial statements.

LO A-1

A.25 Which of the following conditions must be met before an accountant can conduct an examination of an entity's internal control?

a. Management must present its assertion about the effectiveness of its internal control in a written report.

b. Management must represent that there are no internal control deficiencies.
c. The accountant must represent that he or she has not conducted an audit of the financial statements.
d. The accountant must have designed a significant portion of the internal controls.

LO A-3

A.26 When interim financial information is presented in a footnote to annual financial statements, the standard audit report on the annual financial statements should

a. Not mention the interim information unless there is an exception that the auditors need to include in the report.
b. Contain an audit opinion paragraph that specifically mentions the interim financial information if it is not in conformity with GAAP.
c. Contain an extra paragraph that gives negative assurance on the interim information if it has been reviewed.
d. Contain an extra paragraph if the interim information note is labeled "Unaudited."

LO A-2

A.27 During a review of a nonissuer's financial statements, accountants are required to make certain inquiries of management. Which of the following inquiries is *not* required by the *SSARS?*

a. The basis for the preparation of financial statements.
b. Internal control deficiencies.
c. Significant transactions occurring near the end of the reporting period.
d. Material subsequent events.

LO A-4

A.28 According to auditing standards, financial statements presented on a special purpose framework should *not*

a. Contain a note describing the special purpose framework.
b. Describe in general how the special purpose framework differs from generally accepted accounting principles.
c. Be accompanied by an audit report that gives an unmodified opinion with reference to the special purpose framework.
d. Contain a note with a quantified dollar reconciliation of the assets based on the special purpose framework with the assets based on generally accepted accounting principles.

LO A-1

A.29 To be useful, an audit of a service organization's controls should cover a minimum of

a. Three months.
b. Six months.
c. One year.
d. The user entity's fiscal period.

LO A-5

A.30 In providing assurance services to clients, CPAs are building on their reputations for

a. Knowledge and integrity.
b. Objectivity and integrity.

c. Independence and due professional care.
d. Professionalism and trust.

LO A-5
A.31 The AICPA Special Committee on Assurance Services identified five global “mega trends” that can affect a CPA’s business. Which of the following is *not* one of these mega trends?

a. The decreasing supply of natural resources.
b. Information technology.
c. New social structures.
d. Demands for transparency.

LO A-5
A.32 An *assurance service* is defined as a service that

a. Provides auditing services to nonfinancial information.
b. Reviews unaudited financial information.
c. Improves the quality of information for decision makers.
d. Reduces the risk in management decision making.

LO A-5
A.33 B. Harper is surfing the Internet and finds a great pair of rollerblades at a really low price but he has never heard of the company and is concerned that the product he ordered may not be the product he receives. Harper may be more willing to place an order with this company if

a. The website displays the WebTrust seal.
b. The company provides its annual report and the report of the independent auditors on its website.
c. The company provides a money-back guarantee.
d. Only a partial payment is required prior to receiving the product.

LO A-5
A.34 Which of the following is *not* a principle of trust services?

a. Security.
b. Authentication.
c. Privacy.
d. Confidentiality.

LO A-1
A.35 Which of the following statements should be included in a practitioner’s report on the application of agreed-upon procedures?

a. A statement that the practitioner performed an examination of prospective financial statements.
b. A statement of scope limitation that will qualify the practitioner’s opinion.
c. A statement referring to standards established by the AICPA.
d. A statement of negative assurance based on procedures performed.

(AICPA adapted)

LO A-2
A.36 The official *Statements on Standards for Accounting and Review Services* are applicable to practice with

a. Audited financial statements of public companies.

b. Unaudited financial statements of public companies.
c. Unaudited financial statements of nonissuers.
d. Audited financial statements of nonissuers.

LO A-1

A.37 Which of the following is a generally accepted attestation standard but is *not* a fundamental auditing principle?

a. Appropriate competence and capability.
b. Adequate knowledge of the subject matter.
c. Independence.
d. Due care.

LO A-1

A.38 The performance of an attestation engagement on prospective financial information does *not* require which of the following?

a. If the basis of the prospective financial information is different than the financial statements, a reconciliation of the two must be provided.
b. Management must disclose all significant assumptions used in generating the prospective financial information.
c. Management must disclose significant accounting policies and procedures used in generating the prospective financial information.
d. Management must disclose the probability of obtaining the results included in the prospective financial information.

LO A-4

A.39 If the auditor expresses an adverse or disclaimer of opinion on the complete set of financial statements, she or he is not permitted to:

a. Express an unmodified opinion on a single financial statement.
b. Express an unmodified opinion on an element of the financial statements.
c. Express a similar opinion on a single financial statement.
d. Perform any of the above.

LO A-1

A.40 An accountant may allow general distribution of reports based on

a. An agreed-upon-procedures engagement.
b. An examination of prospective financial information.
c. An examination of forecasted financial information.
d. None of the above.

LO A-2

A.41 An accountant need not assess compliance with independence rules during

a. An examination of prospective financial information.
b. A preparation of financial statement engagement.
c. A compilation engagement.
d. A review engagement.

LO A-2

A.42 Which of the following would be considered a preparation of financial statements engagement?

a. Drafting financial statement notes.
b. Preparing financial statements in conjunction with business valuation services.
c. Preparation of personal financial statements for presentation alongside a financial plan.
d. Preparation of financial statements with a tax return solely for submission to taxing authorities.

Exercises and Problems

connect All applicable questions are available with McGraw-Hill's *Connect® Accounting*

A.41

LO A-2

Errors in an Accountants' Review Report. M. Jordan & E. Stone, CPAs, audited the financial statements of Tech Company, a nonissuer, for the year ended December 31, 2013, and expressed an unmodified opinion. For the next year, ended December 31, 2014, Tech issued comparative financial statements. Jordan & Stone reviewed Tech's 2014 financial statements and B. Kent, an assistant on the engagement, drafted the accountants' review report that follows. Stone, the engagement supervisor, decided not to reissue the prior-year audit report but instructed Kent to include a separate paragraph in the current-year review report describing the responsibility assumed for the prior-year audited financial statements. This is an appropriate reporting procedure.

Stone reviewed Kent's draft and indicated in the following supervisor's review notes that the draft contained several deficiencies (assume that U.S. GAAP is the appropriate reporting framework).

Accountants' Review Report—Kent's Draft

We have reviewed and audited the accompanying balance sheets of Tech Co. as of December 31, 2014 and 2013, and the related statements of income and comprehensive income, retained earnings, and cash flows for the years then ended, in accordance with *Statements on Standards for Accounting and Review Services* issued by the American Institute of Certified Public Accountants and generally accepted auditing standards. All information included in these financial statements is the representation of the management of Tech Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements. Because of the inherent limitations of a review engagement, this report is intended for the information of management and should not be used for any other purpose.

We audited the financial statements for the year ended December 31, 2013, and our report was dated March 2, 2014. We have no responsibility for updating that report for events and circumstances occurring after that date.

Jordan and Stone, CPAs

March 1, 2015

Required:

These supervisor's review notes may or may not be correct. For each item a–o, indicate whether Stone is correct (C) or incorrect (I) in the criticism of Kent's draft.

a. The report should contain no reference to the prior-year audited financial statements in the first (introductory) paragraph.
b. All current-year basic financial statements are not properly identified in the first (introductory) paragraph.

c. The report should contain no reference to the American Institute of Certified Public Accountants in the first (introductory) paragraph.
d. Accountants' review and audit responsibilities should follow management's responsibilities in the first (introductory) paragraph.
e. The report should contain no comparison of the scope of a review to an audit in the second (scope) paragraph.
f. Negative assurance should be expressed on the current-year reviewed financial statements in the second (scope) paragraph.
g. The report should contain a statement that no opinion is expressed on the current-year financial statements in the second (scope) paragraph.
h. The report should contain a reference to "conformity with generally accepted accounting principles" in the second paragraph.
i. The report should *not* express a restriction on the distribution of the accountants' review report in the third paragraph.
j. The report should *not* contain a reference to "material modifications" in the third paragraph.
k. The report should indicate the type of opinion expressed on the prior-year audited financial statements in the last paragraph.
l. The report should indicate that no auditing procedures were performed after the date of the report on the prior-year financial statements in the fourth (separate) paragraph.
m. The report should not contain a reference to "updating the prior-year auditor's report for events and circumstances occurring after that date" in the fourth (separate) paragraph.
n. The description of procedures performed in a review engagement in the second (scope) paragraph is incomplete.
o. The review report should have paragraph headings similar to those in an audit report.

(AICPA adapted)

A.42

LO A-1

Review of Forecast Assumptions. Dodd Manufacturing Corporation has engaged you to attest to the reasonableness of the assumptions underlying its forecast of revenues, costs, and net income for the next calendar year, 2015. Four of the assumptions follow.

1. The company intends to sell certain real estate and other facilities held by Division B at an after-tax profit of $600,000; the proceeds of this sale will be used to retire outstanding debt.
2. The company will call and retire all outstanding 9 percent subordinated debentures (callable at 108). The debentures are expected to require the full call premium given present market interest rates of 8 percent on similar debt. A rise in market interest rates to 9 percent would reduce the loss on bond retirement from the projected $200,000 to $190,000.
3. Current labor contracts expire on September 1, 2015, and the new contract is expected to result in a wage increase of 5.5 percent. Given the forecasted levels of production and sales, after-tax operating earnings would be reduced approximately $50,000 for each percentage point of wage increase in excess of the expected contract settlement.
4. The sales forecast for Division A assumes that the new Portsmouth facility will be complete and operating at 40 percent of capacity on February 1, 2015. It is highly improbable that the facility will be operational before January 2015. Each month's delay would reduce Division A sales by approximately $80,000 and operating earnings by $30,000.

Required:

For each assumption, state the evidence sources and procedures you would use to determine the reasonableness of that assumption.

A.43

LO A-1

Internet Exercise: Reporting on Service Organization Controls. Search for a service organization auditor's report on internal controls on the web. (*Hint:* You may have to look under the old name "*SAS 70* reports.") If you cannot find an auditor's report, find a company's news release describing its auditor's service organization report.

Required:

a. Why do you think it is so difficult to find an actual report?
b. If you found an auditor's report, were any deficiencies noted? If so, what were they?
c. Why would a service organization publicize the results of its auditor's report?

A.44

LO A-2

Accounting and Review Services. Henry Horkheimer, MD, is considering expansion of his office as a result of adding a new doctor to his family medical practice. Dr. Horkheimer knows that his business is profitable, but he does not produce regular financial statements, nor does he possess the technical knowledge to do so. Although he is financially savvy enough to know that he needs financial statements to obtain financing to expand his business, he is completely unsure as to what services he needs or even what is available. He has asked you for advice.

Required:

Consider Dr. Horkheimer's need for financing and write a memo outlining the pros and cons of four services an accountant could provide: audit, review, compilation, and preparation of financial statements. Conclude your memo with a recommendation for what you believe would best suit Dr. Horkheimer's needs.

A.45

LO A-2

Compilation and Review Procedures. The following numbered items 1–10 state procedures accountants should consider in review engagements and compilation engagements on the annual financial statements of nonissuers (performed in accordance with AICPA *Statements on Standards for Accounting and Review Services*).

Required:

For each item (taken separately), tell whether the item is required in all review engagements and/or required in all compilation engagements. For each item, give two responses, one regarding review engagements and the other regarding compilation engagements.

1. The accountants should establish an understanding in writing with the entity's management regarding the nature and limitations of the services to be performed.
2. The accountants should make inquiries concerning actions taken at the board of directors' meetings.
3. The accountants, as the entity's successor accountants, should communicate with the predecessor accountants to obtain access to the predecessors' audit documentation.
4. The accountants should obtain a level of knowledge of the accounting principles and practices of the entity's industry.
5. The accountants should obtain an understanding of the entity's internal control.
6. The accountants should perform analytical procedures designed to identify relationships that appear to be unusual.
7. The accountants should assess the risk of material misstatement.
8. The accountants should obtain a letter from the entity's attorney to corroborate the information furnished by management concerning litigation.

9. The accountants should obtain management representations from the entity.
10. The accountants should study the relationship of the financial statement elements that would be expected to conform to a predictable pattern.

(AICPA adapted)

A.46

LO A-2

Compilation Presentation Alternatives. Jimmy C. operates a large service station, garage, and truck stop on Interstate 95 near Plainview. His brother, Bill, has recently joined him as a partner, even though he will continue his small CPA practice. One slow afternoon, they were discussing financial statements with Bert, the local CPA who operates the largest public practice in Plainview.

Jimmy: The business is growing, and sometimes I need to show financial statements to parts suppliers and the loan officers at the bank.

Bert: That so?

Bill: Heck, Jimmy, I know all about that. I can compile a jim-dandy set of financial statements for us.

Bert: Bill can't do compiled financial statements for you. He's not independent.

Jimmy: I know. Momma didn't let him outa the house 'til he was 24. The neighbors complained.

Bert: That so?

Bill: Shucks.

Required:

Think about the financial disclosure problems of Jimmy and Bill's small business.

a. Why does Jimmy need a compilation service?
b. What types of compiled financial statements can be prepared for them and by whom?

A.47

LO A-2

Negative Assurance in Review Reports. One portion of the report on a review services engagement is the following: "Based on my review, I am not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles [or another framework for financial reporting]."

Required:

a. Is this paragraph a "negative assurance" given by the accountants?
b. Why is negative assurance generally prohibited in audit reports?
c. What justification is there for permitting negative assurance in a review services report on unaudited financial statements and on interim financial information?

(AICPA adapted)

A.48

LO A-4

Reporting on a Special Purpose Framework. The following abstracted report is a report on a trust fund that refers to a statutory basis of accounting (special purpose framework) as well as to generally accepted accounting principles (GAAP).

Independent Auditor's Report

To Natalia National Bank Association (Trustee)
and the Unit Holders of the Mega Offshore Trust:

We have audited the accompanying statements of assets, liabilities, and trust corpus—cash basis, of the Mega Offshore Trust as of December 31, 2014 and 2013, and the related statements of changes in trust corpus—cash basis, for each of the three years in the period ended 12 December, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

(Standard scope and responsibility paragraphs here)

As described in Note 2, these financial statements were prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets, liabilities, and trust corpus arising from cash transactions of the Mega Offshore Trust as of December 31, 2014 and 2013, and the related changes in trust corpus arising from cash transactions for each of the three years in the period ended December 31, 2014, on the basis of accounting described in Note 2.

George Costanza, CPA
March 18, 2015

Required:

Write Note 2 to Mega Offshore Trust's 2014 financial statements.

A.49

LO A-2

Prepare a Compilation Report. The Coffin brothers have engaged you to compile their financial schedules from books and records maintained by James Coffin. The brothers own and operate three auto parts stores in Central City. Even though their business is growing, they have not wanted to employ a full-time bookkeeper. James specifies that all he wants is a balance sheet, a statement of operations, and a statement of cash flows. He does not have time to write up footnotes to accompany the financial statements.

James directed the physical count of inventory on June 30 and adjusted and closed the books on that date. You find that he actually is a good accountant, having taken some night courses at the community college. The accounts appear to have been maintained in conformity with generally accepted accounting principles. At least you have noticed no obvious errors.

Required:

You are independent with respect to the Coffin brothers and their Coffin Auto Speed Shop business. Prepare a report on your compilation engagement.

A.50

LO A-2

Reporting on Comparative Unaudited Financial Statements. A. Jones, CPA, performed a review service for the Independence Company in 2014. He wants to present comparative financial statements. However, the 2013 statements were compiled by Able and Associates, CPAs, and Able does not want to cooperate with Jones by reissuing the prior-year compilation report. Jones has no indication that any adjustments should be made to either the 2014 or 2013 statements, which are to be presented with all necessary disclosures. However, he does not have time to perform a review of the 2013 statements. Jones completed his work on January 15, 2015, for the statement dated December 31, 2014.

Required:

Write Jones's review report and include the paragraph describing the report on the 2013 statements. List any assumptions you need to make to write the report.

A.51

LO A-3

Interim Financial Information. June's Java provides coffee services (coffee, cups, cream, sugar, and coffee makers) to local companies for use in their offices. Each of five drivers has a truck with inventory and has a different route each day to replenish coffee supplies to the companies on the route. In past audits, the accountant found that June's Java was having difficulty properly recognizing revenue, usually due to timing issues. In addition, the internal control over inventory on each driver's truck was weak.

June's Java has prepared its third-quarter financial statements and the owners want a review of the information. The accountants have audited the financial statements for the past three years but have never been asked to review any interim financial information until now.

Required:

Prepare a review plan that lists the procedures that accountants should perform to do a professional review in accordance with AU 930. Be as specific as possible in planning your procedures.

A.52

LO A-3

Erroneous Reporting on Interim Financial Information. Baker & Baker, CPAs, prepared the following report on the interim financial information of Micro Mini Company. The interim financial information was presented in the first quarterly report for the three-month period ended March 31, 2015. No comparative quarterly information of the first quarter of the prior year was presented. Baker & Baker completed a review in accordance with standards established by the AICPA and found that, to the best of their knowledge, the information was presented in conformity with GAAP. In an audit report dated January 21, 2015, Baker & Baker had given a standard unmodified audit report on Micro Mini's 2014 and 2013 annual financial statements.

Report of Independent Auditors

To the Board of Directors and Stockholders,
Micro Mini Company:

We have made a review of the balance sheet of Micro Mini Company at March 31, 2015, the related statement of income and comprehensive income for the three-month period ended March 31, 2015, and the statement of cash flows for the three-month period ended March 31, 2015, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of the interim financial information, applying analytical review procedures to financial data, and making inquiries to persons responsible for financial and accounting matters.

In our opinion, the accompanying interim financial information presents fairly, in all material respects, the financial position of Micro Mini Company at March 31, 2015, and the results of its operations and its cash flows for the three-month period then ended in conformity with generally accepted accounting principles.

Baker & Baker, CPAs
March 31, 2015

Required:

a. Review the report and list, with explanation, the erroneous portions in it.
b. Rewrite the report.

A.53

LO A-4

Report on Special Purpose Framework. Brooklyn Life Insurance Company prepares its financial statements on a statutory basis in conformity with the accounting practices prescribed and permitted by the Insurance Department of the State of New York. This statutory basis produces financial statements that differ materially from statements prepared in conformity with generally accepted accounting principles. On the statutory basis, for example, agents' first-year commissions are expensed instead of being partially deferred.

The company engaged its auditors, Major and Major Associates, to audit the statutory basis financial statements and report on them. Footnote 10 in the statements contains a narrative description and a numerical table explaining the differences between the statutory basis and GAAP accounting. Footnote 10 also reconciles the statutory basis assets, liabilities, income, expense, and net income (statutory basis) to the measurements that would be obtained using GAAP.

Required:

Write the audit report appropriate in the circumstances. The year-end date is December 31, 2014, and the audit fieldwork was completed on February 20, 2015. (The company plans to distribute this report to persons other than the department of insurance regulators, so the auditors need to follow AU 700.)

A.54

LO A-5

Internet Exercise: CPA WebTrust. Visit the AICPA WebTrust site (www.webtrust.org).

Required:

a. What is WebTrust?
b. Why is WebTrust needed?
c. How does an Internet user know that a website has received the WebTrust service?
d. Where can a person obtain copies of the Trust service principles?

A.55

LO A-5

Assurance Services. In 2008, the AICPA Assurance Services Executive Committee identified five global "mega trends" that can affect a CPA's business.

Required:

a. Review the mega trends that were identified. Are these trends still viable in today's society and economy? Which trends, if any, need to be reconsidered because of current conditions in society and the economy?
b. Are there additional trends in the marketplace that could affect a public accounting firm's business?

A.56

LO A-5

Assurance Services. Davis has a store that sells old baseball cards. To expand the business, he has decided to open an Internet site where potential customers can view the cards and place orders. Davis hires Johnson, who is an expert in constructing websites for small businesses. She explains that even with a quality website and pictures of the merchandise for sale, customers may be reluctant to purchase baseball cards from Davis's website.

Required:

a. Explain the reasons for Johnson's concerns.

b. What steps can Davis and Johnson take to reduce customer's reluctance to make purchases on the Internet?

A.57

LO A-5

Assurance Services. Henry's Health Food Store maintains a perpetual inventory on its computer. The sales representative from A-Plus Vitamins has recommended the following to Henry:

- All the files should have password protection.
- A-Plus Vitamins should be given the URL and the password for Henry's inventory file on the computer, which can be accessed from outside.
- A-Plus Vitamins will search the inventory for items that fall below an established reorder point and will automatically ship a set amount of product to Henry's.

Required:

a. What are the advantages of this arrangement for Henry's? For A-Plus Vitamins?

b. What concerns might Henry's have in this arrangement?

c. How might these concerns be addressed?

A.58

LO A-5

Internet Assignment: Global Reporting. Go to the Global Reporting Initiative website (**www.globalreporting.org**) and obtain the G4 Reporting Principles and Standard Disclosures.

Required:

a. Identify the three primary categories of sustainability indicators identified in the G4 reporting standards. For each category, define the types of indicators included and list several aspects of the category as described in Section 5 of the standard.

b. How can CPAs provide assurance for sustainability reporting as a service to their clients?

A.59

LO A-1

Attestation Evaluation Criteria. The local high school experienced trouble two years ago. Its graduation rates had declined to the bottom 10 percent in the state, college admission rates were low, and graduates had a high unemployment rate. The school board and administration have notified the state Department of Education and the taxpayers in the school district that these problems have been fixed. Graduation rates have increased, a higher percentage of students are continuing with their education, and a higher percentage of graduates have jobs. The Department of Education wants an independent attestation to these assertions. It is concerned not only about the numbers claimed by the school board and administration but also about the underlying process and means used to obtain these numbers.

Required:

Establish a list of criteria you would use to validate the claim of the school board and administration and to determine the processes and means used to obtain these numbers.