PacificCPE

COURSE
20452A

Compilation and Review Engagement Requirements

Focused on the core standards for two of the most common engagements in public accounting, this course covers AR-C Section 80 on compilation engagements—including a side-by-side comparison of old and new reporting requirements—and AR-C Section 90 on review engagements. Whether you perform these services regularly or are refreshing your knowledge, you'll come away with a clear understanding of what each engagement requires and how the updated standards change your reporting responsibilities.

CREDIT HOURS 2 | FIELD OF STUDY ACCOUNTING | EXAM QUESTIONS 10

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LEARNING ASSIGNMENTS AND OBJECTIVES

Assignment

- Study the full course materials included here.
- Complete the review questions after each chapter.
- Answer 10 final exam questions.
- Final exam is scored immediately, 70% or better passes.
- Certificate of completion is available in your account.
- Failed exams can be retaken free of charge.

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Publication Date: April 2026

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Section 3

Assignment 3 Objectives

After completing this chapter, you should be able to:

- Recall the objective of a compilation engagement under AR-C 80 of SSARS No. 21.
- Identify some procedures that must be performed in a compilation engagement under AR-C 80 of SSARS No. 21.
- Recognize some of the changes made to the compilation report under SSARS No. 21, including those related to special purpose frameworks and GAAP departures, among others.
- Recall how an accountant should report when there is a lack of independence in a compilation engagement.

IV. AR-C SECTION 80- COMPILATION ENGAGEMENTS

A. INTRODUCTION

AR-C 80, *Compilation Engagements*, is part of SSARS No. 21 and encompasses the new compilation standards that replace the previous compilation rules found in AR 80 of SSARS No. 19.

AR-C 80 states the objective of a compilation engagement is:

To apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

In general, a compilation engagement is one in which an accountant uses his or her expertise to "read and report" on financial statements.

A compilation engagement is not a preparation of financial statements engagement.

B. SCOPE OF AR-C 80- COMPILATION ENGAGEMENTS

AR-C 80 provides the following scope for engagements that are covered under the compilation rules.

1. An engagement is subject to the compilation rules found in AR-C 80 only when the accountant is engaged (hired) to perform a compilation of:
   - Financial statements
   - Prospective financial information, including forecasts and projections

- Pro forma financial information, and
- Other historical financial information.

2. In addition to the list of engagement types found in Paragraph 1 above, a compilation engagement may be performed on the following historical financial information:
   - Specified elements, accounts, or items of a financial statement, such as schedules of rentals, royalties, profit participation, or provision for income taxes
   - Supplementary information, and
   - Required supplementary information.
3. The existing rules that a compilation engagement is required if an accountant submits financial statements is eliminated.

C. OBJECTIVE OF A COMPILATION ENGAGEMENT

AR-C 80 states that the accountant's objective in a compilation engagement is to do the following: "apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with this standard (AR-C 80) without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework."

1. A compilation engagement is separate from a preparation of financial statements engagement performed under AR-C 70 (a nonattest engagement).

> ***Note***
>
> An accountant can be engaged to perform a compilation engagement and not prepare financial statements. If the accountant is hired to both prepare financial statements and perform a compilation engagement on them, the engagement letter must identify both services separately.

D. REQUIREMENTS- COMPILATION ENGAGEMENTS- AR-C 80

An accountant who performs a compilation engagement, must comply with the following rules found in AR-C 80:

1. In addition to complying with AR-C 80, an accountant is required to comply with AR-C 60, General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services.
2. The accountant must determine whether the accountant is independent of the entity.

Note

In a compilation engagement, the accountant must determine whether he or she is independent. If not independent, the accountant is still permitted to perform the compilation engagement provided he or she notes the lack of independence in the compilation report.

3. Acceptance and continuance of client in compilation engagement:

As a prerequisite to an accountant accepting a compilation engagement with respect to an entity's financial statements, the accountant must meet certain preconditions as follows:

a) The accountant must satisfy general preconditions found in paragraphs .25 of the general conditions in AR-C 60, which state that the accountant should not accept an engagement to be performed in accordance with SSARSs if:

1) The accountant has reason to believe that relevant ethical requirements (including independence) will not be satisfied

2) The accountant's preliminary understanding of the engagement circumstances indicates that information needed to perform the engagement is not likely to be available or reliable, or

3) The accountant has cause to doubt management's integrity such that it is likely to affect the performance of the engagement.

b) The accountant must satisfy two requirements found in paragraph .26 of AR-C 60 general conditions which state that the accountant should:

1) Requirement 1: Determine whether the financial reporting framework selected by management to be applied to the preparation of the financial statements is acceptable.

2) Requirement 2: Obtain the agreement of management (through an engagement letter) that it acknowledges and understands its responsibility.

Independence- Compilation Engagement and Preparation of Financial Statements

It is typical for an accountant who performs a compilation engagement to also prepare financial statements. The preparation of financial statements is a nonattest service while the compilation engagement is an attest engagement.

If an accountant performs a compilation engagement and also prepares financial statements, the accountant is performing a nonattest service (preparation) for an attest client. In such a case, the accountant's independence is impaired unless the accountant applies certain safeguards required by the Nonattest Services subtopic of the Independence Rule found in ET sec. 1.295 of the AICPA Professional Standards.

Those safeguards, which are discussed further in the review engagement section of this course include three requirements:

1. The client must agree to assume management responsibilities for the nonattest service (preparation of financial statements, in this case)
2. The accountant must not assume management responsibilities for the nonattest service performed (preparation of financial statements, in this case), and
3. There must be language in the engagement letter that confirms that the client, not the accountant, assumes management responsibility for the nonattest service performed (e.g., preparation of financial statements, in this case).

E. ENGAGEMENT LETTER- COMPILATION

AR-C 80 provides the following guidance for an accountant to obtain agreement on the compilation engagement terms:

1. The accountant should agree upon the terms of the engagement with management or those charged with governance, as appropriate.
2. The agreed-upon terms of the engagement should be documented in an engagement letter or other suitable form of written agreement and should include the following:
   a) The objectives of the engagement
   b) The responsibilities of management
   c) The responsibilities of the accountant
   d) The limitations of the compilation engagement
   e) Identification of the applicable financial reporting framework for the preparation of the financial statements, and
   f) The expected form and content of the accountant's compilation report, and a statement that there may be circumstances in which the report may differ from its expected form and content.
3. The engagement letter or other suitable form of written agreement should be signed by both:
   a) The accountant or the accountant's firm, and
   b) Management or those charged with governance, as appropriate.

Observation

SSARS No. 21 requires that all engagement letters involving SSARS engagements (preparation, compilation, and review engagements) must be signed by both the accountant and management and/or those charged with governance.

4. The understanding with management regarding the services to be performed for compilation engagements is required to be in a documented form, and, accordingly, an oral understanding is insufficient[1].

Following are illustrations of engagement letters extracted from the exhibits to SSARS No. 21, as modified by the AICPA Guide and the Author.

Illustration 1 - An Engagement Letter for an Engagement to Prepare Financial Statements in Accordance with U.S. GAAP and to Perform a Compilation Engagement with Respect to Those Financial Statements

Facts:

- The accountant is hired to prepare, as a nonattest service, the financial statements, including related notes.
- The accountant is also hired to perform a compilation engagement on the same financial statements for the same *period.*
- U.S. GAAP is the applicable framework.
- The accountant expects that his or her independence will not be impaired by performing the preparation of financial statements nonattest service.

To the appropriate representative of management of ABC Company:

You have requested that **we prepare the financial statements of ABC Company**, which comprise the balance sheet as of December 31, 20XX and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the financial statements, and **perform a compilation engagement with respect to those financial statements**. We are pleased to confirm our acceptance and our understanding of this compilation engagement by means of this letter.

We will also perform the following additional services: preparation of the 20XX federal and state income tax returns, and perform bookkeeping services. (a)

Our Responsibilities

The objective of our engagement is to:

a. **Prepare financial statement**s in accordance with accounting principles generally accepted in the United States of America based on information provided by you, and

b. **Apply accounting and financial reporting expertise to assist you in the presentation of financial statements** without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARSs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to and will not verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion, nor provide any assurance on the financial statements.

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

Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that **our role is the preparation of the financial statements** in accordance with accounting principles generally accepted in the United States of America and **to assist you in the presentation of the financial statements** in accordance with accounting principles generally accepted in the United States of America. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARSs:

a. The selection of accounting principles generally accepted in the United States of America as the financial reporting framework to be applied in the preparation of financial statements

b. The design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the financial statements

c. The prevention and detection of fraud

d. To ensure that the entity complies with the laws and regulations applicable to its activities

e. To make all financial records and related information available to us

f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments, you provide to us for the engagement

g. To provide us with:

- Access to all information of which you are aware is relevant to the preparation and fair presentation of the financial statements, such as records, documentation, and other matters
- Additional information that may be requested of management for the purpose of the engagement, and
- Unrestricted access to persons within the Company of whom we determine necessary to make inquiries.

h. The preparation and fair presentation of financial statements in accordance with accounting principles generally accepted in the United States of America and the inclusion of all informative disclosures that are appropriate for accounting principles generally accepted in the United States of America.

You are also responsible for all management decisions and responsible for designating an individual with suitable skills, knowledge, and experience to oversee our preparation of your financial statements. You are responsible for evaluating the adequacy and results of services performed and accepting responsibility for such services. [AICPA ET 1.295- Nonattest Services] (b)

You are also responsible for including the following reference on each page of the financial statements including supplementary information: "See Accountant's Compilation Report."(c)

Our Report

As part of our engagement, we will issue a report that will state that we did not audit or review the financial statements and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on them. There may be circumstances in which the report differs from the expected form and content.

You agree to include the compilation report in any document containing financial statements that indicates that the entity's accountant has performed a compilation engagement on such financial statements and, prior to inclusion of the report, to ask our permission to do so.

Other relevant information

Our fees for these services . . . .

[The accountant may include language, such as the following, regarding limitation of or other