PacificCPE

COURSE
20454A

Practice Issues: Reporting, Fraud, and Going Concern

Transitioning from standards to real-world application, this course digs into practical issues that arise during compilation and review engagements. Topics include key observations practitioners need to keep in mind and the specific requirements around considering fraud across different engagement types. If you've ever wondered how the standards play out when things get complicated in practice, this course offers concrete guidance to help you navigate those situations with confidence.

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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Section 1

SECTION 1: PRACTICE ISSUES: COMPILATION AND REVIEW

Assignment 1 Objectives

After completing this chapter, you should be able to:

- Identify the reporting options for controllers who seek to issue financial statements.
- Recognize the accountant's responsibility for reporting fraud in compilation and review engagements.
- Identify the types of analytical procedures that can and cannot be used in a review engagement.
- Recognize certain terms used as the basis for evaluating going concern in a review engagement.
- Identify factors that may or may not suggest there is a potential going-concern problem in a compilation or review engagement.
- Identify the period of time that defines "reasonable period of time" in going concern.
- Recognize the threshold to evaluate an Altman Z Score.

IX. PRACTICE ISSUES- PART 1

A. CONTROLLERS ISSUING FINANCIAL STATEMENTS

For years, accountants have performed write-up services for clients in addition to performing a compilation, review or even an audit engagement. More recently, those services have expanded to part-time controllership. Because bookkeeping and controllership functions, by themselves, do not necessarily entail issuing a report, many accountants take it for granted that such engagements are risk- free.

Yet, recent statistics obtained from major insurance carriers reach a different conclusion.

1. Malpractice cases against accountants in write-up services have risen dramatically in recent years.
   a) Undetected fraud is the number one charge against accountants in write-up engagements, with the focus on cash and accounts receivable.
   b) Accountants in part-time controllership cases are being held to a higher standard than acting as an internal accountant.
2. Accountants may have a lack of independence depending on the degree of services provided.

3. To mitigate some of the risks associated with write-up and bookkeeping engagements, the following are a few suggestions:
   a) Make sure you obtain an engagement letter for both write-up services and part-time controllership engagements.
   b) Make sure your malpractice insurance covers controllership since the service could be construed as an employer-employee relationship rather than a professional-client relationship.
   c) Watch out for independence issues if you plan to issue a report.
      - Part-time controllers should consider whether they need to issue a report and the impact of their position on the ability to do so.

The following section discusses the present developments with the controllership issue.

The general rule is that an accountant in public practice is permitted to issue a compilation report even if he or she is not independent, provided the report identifies the fact that he or she is not independent.

Yet, many accountants provide part- or full-time controllership services, including:

1. Maintaining the accounting books and records
2. Preparing financial statements, and
3. Performing certain management functions for their clients, such as hiring employees, authorizing purchases, investing idle cash, signing checks, or serving as an officer or director of a company.

ET sec. 1.295, *Nonattest Services,* of the AICPA Code of Professional Conduct, provides that if an accountant performs certain activities for an attest client that are considered assuming management responsibility, he or she has impaired his or her independence with respect to that particular client.

Whether an activity is a management responsibility depends on the circumstances and requires the exercise of judgment. Examples of activities that would be considered management responsibilities and, as such, impair independence if performed for an attest client, include:

- Setting policy or strategic direction for the attest client.
- Directing or accepting responsibility for actions of the attest client's employees except to the extent permitted when using internal auditors to provide assistance for services performed under auditing or attestation standards.
- Permitting when using internal auditors to provide assistance for services performed under auditing or attestation standards.

- Authorizing, executing, or consummating transactions or otherwise exercising authority on behalf of an attest client or having the authority to do so.
- Preparing source documents, in electronic or other form, that evidence the occurrence of a transaction.
- Having custody of an attest client's assets.
- Deciding which recommendations of the member or other third parties to implement or prioritize.
- Reporting to those charged with governance on behalf of management.
- Serving as an attest client's stock transfer or escrow agent, registrar, general counsel or equivalent.
- Accepting responsibility for the management of an attest client's project.
- Accepting responsibility for the preparation and fair presentation of the attest client's financial statements in accordance with the applicable financial reporting framework.
- Accepting responsibility for designing, implementing, or maintaining internal control.
- Performing ongoing evaluations of the attest client's internal control as part of its monitoring activities.

If the accountant does any of the previously noted activities on behalf of an attest client, he or she is not independent.

For years, there was confusion as to the extent to which CPAs could avoid issuing compilation reports on financial statements. On one side of the issue, there were CPAs in public practice who also provided management services (as listed above) for their clients. Some CPAs in this situation argued that because they were both engaged in public practice and performing management services, they could choose to issue financial statements in the capacity as a member of management, not public practice. Thus, they argued that requirements to issue a compilation report under the SSARSs did not apply. The result was that the compilation report was replaced with the issuance of a transmittal letter sent to the third party along with the financial statements.

On the other side of the issue, there were CPAs in industry who were issuing financial statements for their employers. Instead of issuing the financial statements with a transmittal letter, they issued them with a compilation report noting a lack of independence in the report.

Thus, CPAs in public practice who performed management services bypassed the requirements of the SSARSs (compilation report), and CPAs in industry issued compilation reports for their employer companies.

There simply was no authority to deal with the cross over between CPAs in industry and public practice.

For CPAs in industry who issued a compilation report for their employer, nothing in the SSARSs precluded them from doing so provided they noted the lack of independence.

For CPAs in public practice who issued merely a transmittal letter in the capacity as a member of management, AICPA Ethics Ruling No. 10 gave some guidance for an accountant in industry who was also a stockholder, partner, director, officer, or employee of an entity for which he or she prepared financial statements to be transmitted to a third party. Effective December 15, 2014, Ethics Ruling No. 10 is deleted and replaced with Ethics Interpretation 2.300.030, Submission of Financial Statements of the AICPA Code of *Professional Conduct.*

Ethics Interpretation 2.300.030, Submission of Financial Statements of the AICPA Code of Professional Conduct, states:

> "When a member (accountant) is a stockholder, a partner, a director, an officer, or an employee of an entity and, in this capacity, prepares or submits the entity's financial statements to third parties, the member should clearly communicate, preferably in writing, the member's relationship to the entity and should not imply that the member is independent of the entity."

The Ethics Ruling essentially indicated that an accountant can issue financial statements in his or her capacity as a stockholder, partner, director, officer, or employee of a client, provided he or she indicates his or her relationship to the entity; that is, indicates an employment title or the fact that the accountant is a "part-time controller."

Thus, existing authority has appeared to authorize the crossover of activities by CPAs in industry and public practice. Yet, many observers have taken the position that, although not stated in the SSARSs, a compilation report is supposed to be issued by an accountant in public practice, not industry. And, the use of a transmittal letter and the avoidance of the issuance of a compilation report should be set aside for CPAs who were truly part of management, exclusive of CPAs that provided part-time controllership work.

To add more confusion to the situation, newly issued SSARS No. 21 provides an additional preparation of financial statements engagement which calls into question whether a CPA in industry can perform a preparation engagement under SSARS No. 21.

Question: If an accountant is in public practice and provides an entity with controllership or other management services that entail the submission of financial statements, is the accountant required to follow the requirements of the *SSARSs?*

Interpretation: Prior to 2015, there was authority to address situations in which an accountant was issuing financial statements in the capacity of a stockholder, partner, director, officer, or employee of an entity. That authority was found in Interpretation No. 8 ofAR-80, *Applicability of Statements on*

Standards for Accounting and Review Services When Performing Controllership or Other Management Services.

With the issuance of SSARS No. 21, all previous SSARS interpretations, including Interpretation No. 8, have been superseded. Thus, starting in 2015, there really is no authority to deal with situations in which an accountant issues financial statements in the capacity of being part of management, or a stockholder.

Nevertheless, the author believes that the general framework of Interpretation No. 8 still applies and that accountants should follow it for years 2015 and later.

Here is the general framework to be followed:

1. An accountant is in public practice and is not a stockholder, partner, director, officer, or employee of the entity:

   If engaged (hired) to perform a SSARS No. 21 engagement, the accountant must follow the SSARS No. 21 requirements for a preparation, compilation, or review engagement.

   If not engaged (hired) to perform a SSARS No. 21 engagement, the accountant has no reporting requirements under SSARS No. 21 or any other standards.

2. If an accountant is in public practice and is also a stockholder, partner, director, officer, or employee of the entity, the accountant may do one of the following:

   Option 1: If engaged (hired) as a CPA in public practice to perform a SSARS No. 21 [3] engagement, follow the SSARS No. 21 requirements as follows:

   - The accountant may perform a preparation of financial statements engagement.
   - The accountant may perform a compilation engagement and disclaim lack of independence.
   - The accountant is not permitted to perform a review engagement due to lack of independence.

   Option 2: If not engaged (hired) to perform a preparation, compilation, or review engagement in the capacity as a CPA in public practice:

   - Issue the financial statements to third parties in the capacity as a stockholder, partner, director, officer, or employee of the entity with a transmittal letter
   - Communicate to the third parties the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee), and
   - Not imply that the accountant is independent.

3. If an accountant is not in public practice and is a stockholder, partner, director, officer, or employee of the entity, the accountant may do one of the following:

a) Accountant is not permitted to perform a SSARS No. 21 engagement because he or she is not in public practice.

b) Accountant may:

- Issue the financial statements to third parties in the capacity as a stockholder, partner, director, officer, or employee of the entity with a transmittal letter
- Communicate to the third parties the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee), and
- Do not imply that the accountant is independent.

The following is an example of the type of communication that may be used by the accountant who issues financial statements in his or her capacity as a stockholder, partner, director, officer, or employee of the entity:

> The accompanying balance sheet of Company X as of December 31, 20XX, and the related statements of income and cash flows for the year then ended have been prepared by (name of accountant), CPA. I have prepared such financial statements in my capacity (describe capacity, for example, as director) of Company X.

If an accountant is not in public practice, the issuance of a report under SSARS No. 21 would be inappropriate; however, the previously mentioned communication may be used.

The following chart summarizes the approach that should be used.

Facts: An accountant performs management or controllership services for a client:

Description	Acceptable Action
CPA is in public practice and is not a stockholder, partner, director, officer, or employee of the entity.	If engaged (hired) to perform a SSARS No. 21, the accountant must follow the SSARS No. 21 requirements for a preparation, compilation or review engagement. If not engaged (hired) to perform a SSARS No. 21 engagement, the accountant has no reporting requirements under SSARS No. 21 or any other standards.
CPA is in public practice and is also a stockholder, partner, director, officer, or employee of the entity.	CPA has a choice. **Option 1:** If engaged (hired) as a CPA in public practice to perform a SSARS No. 21 engagement, follow the SSARS No. 21 requirements as follows: • The accountant may perform a preparation of financial statements engagement. • The accountant may perform a compilation engagement and disclaim lack of independence. • The accountant is not permitted to perform a review engagement due to lack of independence. **Option 2:** If not engaged (hired) to perform a preparation, compilation, or review engagement in the capacity as a CPA in public practice: • Issue the financial statements to third parties in the capacity as a stockholder, partner, director, officer, or employee of the entity • Communicate to the third parties the accountant's relationship to the entity (for example, stockholder, partner, director, officer, or employee), and • Do not imply that the accountant is independent