PacificCPE

COURSE
20457A

Advanced Practice Issues in Compilation Engagements

Rounding out the practice issues series, this course covers Part 2 of common challenges encountered in compilation and review work. Through observations and scenario-based discussion, practitioners explore situations that require careful judgment and a strong command of the underlying standards. Designed for experienced CPAs looking to sharpen their practical skills, this course also addresses additional assignment objectives to reinforce and test your understanding of the material covered.

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

Start Course ↓ | Final Exam Copy ↓

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.

Course Objectives

- Recognize the general disclosure rules when issuing a compilation report on a specified element.
- Identify when a management representation letter is required and some general rules pertaining to such letters.
- Identify a prescribed form and the options for reporting on personal financial statements.

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Section 1

Chapter Objective

After completing this chapter, you should be able to:

- Recognize the general disclosure rules when issuing a compilation report on a specified element.
- Identify when a management representation letter is required and some general rules pertaining to such letters.

X. PRACTICE ISSUES- PART 2

A. RESTRICTING THE USE OF AN ACCOUNTANT'S COMPILATION OR REVIEW REPORT

Are there instances in which an accountant is required to restrict the use of his or her compilation or review report?

The answer is "yes."

Typically, accountants are not concerned about third-party liability in connection with compilation, review, or even audit reports that are issued to third parties. In most cases, the client financial statements are being distributed to the client, and to a few third parties, such as banks and vendors.

In some situations, where the accountant considers the client to be high-risk or may be engaging in a high-risk transaction, such as the sale of a business or raising of capital, the accountant may wish to restrict the use of the report.

Although an accountant may have a strong engagement letter, that letter is a contract between the accountant and the client, and does not necessarily protect the accountant from claims made by known third parties who rely on the accountant's report on the financial statements.

Background

SSARS No. 21 provides guidance to accountants on restricting the use of reports issued under SSARS No. 21 as follows:

- Compilation report: Permits but does not require restricted use
- Review report: Requires restricted use in certain instances

In general, the following terms are used in this section:

Restricted use: Applies to reports intended only for one or more specified third parties. The need to restrict use may result from several circumstances including, but not limited to:

- The purpose of the report, and
- The potential for the report to be misunderstood when taken out of the context in which it was intended to be used.

General use: Applies to reports that are not restricted to specified parties, including reports on financial statements prepared in conformity with an applicable financial reporting framework that are ordinarily not restricted to use, such as GAAP or a special purpose framework.

Reports on GAAP and tax-basis financial statements ordinarily are not restricted regarding use, although nothing precludes an accountant from restricting the use of any report.

Restricted Use Review Report

SSARS No. 21 states that in certain instances, an accountant's review report should include an alert (restriction), in a separate other-matter paragraph, that restricts its use.

1. Situations in which the review report should include an alert (restriction) are when:
   a) There are measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria, or
   b) There are measurement or disclosure criteria that are available only to the specified parties.
2. The language that restricts the use of the accountant's review report should:
   a) State that the accountant's review report is intended solely for the information and use of the specified parties
   b) Identify the specified parties for whom use is intended, and
   c) State that the accountant's review report is not intended to be and should not be used by anyone other than the specified parties.

Note

The language that restricts the use of the accountant's review report may list the specified parties or refer to the specified parties listed elsewhere in the accountant's review report. Moreover, the restricted use report is not used for nonspecified parties.

Illustrative language:

The following illustrates language that would be included in a review report as an other-matter paragraph:

> **Restricted Use**
>
> This report is intended solely for the information and use of [list or refer to the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

3. When the accountant includes an alert that restricts the use of the accountant's review report to certain specified parties and the accountant is requested to add other parties as specified parties, the accountant should determine whether to agree to add the other parties as specified parties.
   a) If the other parties are added after the release of the accountant's review report, the accountant should take one of the following actions:
      - Amend the accountant's review report to add the other parties. In such circumstances, the accountant should not change the original date of the accountant's review report.
      - Provide a written acknowledgment to management and the other parties that such parties have been added as specified parties. The accountant should state in the acknowledgment that no procedures were performed subsequent to the original date of the accountant's review report.
4. When the accountant is requested to add other parties as specified parties, the accountant may agree to add other parties as specified parties based on the accountant's consideration of factors, such as the identity of the other parties and the intended use of the accountant's review report.

Note

In addition, the accountant should include language in the engagement letter restricting use and distribution of the financial statements to parties outside the list of specified parties.

Restricted Use Compilation Report

Unlike a review report, SSARS No. 21 does not provide any instances in which an accountant must restrict the use of a compilation report.

However, nothing precludes an accountant from restricting the use of a compilation report by inserting the same language in an other-matter paragraph as used in a review report.

> This report is intended solely for the information and use of [list or refer to the specified parties] and is not intended to be and should not be used by anyone other than these specified parties.

A restricted use paragraph might be warranted in a compilation report in situations in which:

- There are measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users who can be presumed to have an adequate understanding of the criteria, or
- There are measurement or disclosure criteria that are available only to the specified parties.

What if the client does distribute a restricted use report and financial statements to parties outside the identified list?

If the client distributes the financial statements and accountant's report to a third party that is not one of the authorized parties identified in the report and engagement letter, the accountant would have a breach of contract claim against the client if the accountant were sued by the unauthorized party.

Is it prudent for an accountant to voluntarily restrict the use of his or her compilation or review report even if not otherwise required to be restricted?

Yes. As previously noted, an accountant is required to restrict use of a review report in certain instances in which there are measurement or disclosure criteria that are determined by the accountant to be suitable only for a limited number of users.

No such requirement applies to a compilation report.

Regardless of the SSARS No. 21 requirement, an accountant may choose to restrict use of his or her compilation or review report for other reasons. One reason might be where the accountant wants to limit the specified third parties that receive the financial statements, such as certain identified banks. Nothing in SSARS No. 21 prevents an accountant from restricting the use of the report for any reason. If such a restriction is included in the compilation or review report, there should be similar language included in the engagement letter.

B. REPORTING OF SPECIFIED ELEMENTS, ACCOUNTS, OR ITEMS OF A FINANCIAL STATEMENT

There are instances in which an accountant may wish to prepare, compile, or review a specified element, account, or item of a financial statement in lieu of a full set of financial statements.

Prior to the issuance of SSARS No, 21, the guidance was found in SSARS No. 13, *Compilation of Specified Elements, Accounts, or Items of a Financial Statement* (AR 110). SSARS No. 21 has replaced SSARS No. 13 and provides little specific guidance as to how to report on specified elements.

Although SSARS No. 13 no longer applies, there is important information that was previously found that still should be followed if an accountant wishes to report on a specified element, account, or an item of a financial statement:

1. Rules:
   a) SSARS No. 21 permits an accountant to perform a preparation of financial statements, compilation or review engagement on a specified elements, accounts, or items of a financial statement.

      Examples of specified elements, accounts, or items of a financial statement that an accountant may compile include schedules of:

      - Rentals
      - Royalties
      - Profit participation
      - Receivables or inventory
      - Provision for income taxes

   b) The engagement may be undertaken as a separate engagement or in conjunction with another engagement.
2. Performance and reporting requirements: An accountant who compiles specified elements, accounts, or items of a financial statement should follow:
   a) The preconditions of Paragraphs .25 and .26 of AR-C 60, and

   b) The specific preconditions of the preparation, compilation or review engagement.

Example: An accountant is asked to perform a compilation engagement on a schedule of gross sales.

Conclusion: Following is a sample of a report and related schedule to be issued under SSARS No. 21.

Sample Compilation Report- Specified Element

Management is responsible for the presentation and fair presentation of the accompany schedule of gross sales of XYZ Restaurant Inc. for the year ended December 31, 20X1 in accordance with accounting principles generally accepted in the United States of America. I (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. I (We) did not audit or review the schedule of gross sales nor was (were) I (we)

required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on the schedule of gross sales.

James J. Fox & Company

Burlington, Massachusetts

March 31, 20X1

XYZ Restaurant Inc.

Schedule of Gross Sales

For the Year Ended December 31, 20XX

Gross sales:	
Restaurant food	$1,500,000
Restaurant bar	800,000
Catering	400,000
On-line sales	600,000
Special events	300,000
Sundry other sales	100,000
	$3,700,000

Note

The legend "See Accountant's Compilation Report" or similar language may be placed on the schedule, although such language is not required under SSARS No. 21.

What about a review report on a specified element, account, or financial statement item?