to the financial statements taken as a whole. Furthermore, the auditor should not express an opinion on the specified data when he or she has expressed an adverse opinion or disclaimed an opinion on the financial statements unless the specified data constitute only an insignificant portion of the financial statements. Finally, the use of the report is limited to parties who understand the royalty agreement.

COMPLIANCE REPORTS RELATED TO AUDITED FINANCIAL STATEMENTS

Audit Decision 6

■ Under what circumstances can an auditor audit and report on compliance with contractual agreements?

Companies may be required by contractual agreements or regulatory agencies to furnish compliance reports by independent auditors. For example, bond indentures often impose a variety of obligations on borrowers such as payments to sinking funds, maintenance of a minimum current ratio, and restrictions on dividend payments. In addition to requiring audited financial statements, lenders or their trustees often request assurance from the independent auditor that the borrower has complied with the accounting and auditing covenants of the agreement. The auditor satisfies this request by giving *negative assurance* on compliance by stating that "nothing came to our attention which would indicate that the company is not in compliance." AU 623.19 states that this assurance should not be given unless the auditor has audited the financial statements to which the agreements or regulatory requirements relate.

Furthermore, such assurance should not extend to covenants that relate to matters that have not been subjected to the audit procedures performed in the financial statement audit, and should not be given when the audit resulted in an adverse opinion or a disclaimer of opinion.

The auditor's assurance on compliance may be given in a separate report or in one or more explanatory paragraphs following the opinion paragraph of the report on the audited financial statements. The report language should restrict the distribution of the information on negative assurance to parties within the entity (such as the board of directors), parties to the loan agreement, or the regulatory agency. A separate report on debt compliance is illustrated in Figure 20-6.

Figure 20-6 ■ Special Report on Debt Compliance Given as a Separate Report

Independent Auditor's Report

We have audited, in accordance with auditing standards generally accepted in the United States of America, the balance sheet of XYZ Company as of December 31, 20X2, and the related statements of income, retained earnings, and cash flows for the year then ended, and have issued our report thereon dated February 16, 20X3.

In connection with our audit, nothing came to our attention that caused us to believe that the company failed to comply with the terms, covenants, provisions, or conditions of sections XX to XX, inclusive of the indenture dated July 20, 20X0, with ABC Bank insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

This report is intended solely for the information and use of the boards of directors and management of XYZ Company and ABC Bank and is not intended to be and should not be used by anyone other than these specified parties.

Source: AU 623.21.

[LEARNING CHECK

20-1 a. Describe four basic levels of assurance that can be rendered by CPAs in a variety of engagements.
b. Identify three groups of professional standards that are issued by the Auditing Standards Board. Briefly describe the types of professional services that are covered by each group of standards.

20-2 a. What types of reports are encompassed by the term *special reports* as described in AU 623?
b. State the common characteristics of the types of data covered by special reports.

20-3 a. When is a basis of accounting considered to be an other comprehensive basis of accounting (OCBOA)?
b. Explain the effects on the auditor's standard report when reporting on financial statements prepared on an OCBOA.

20-4 a. Describe the types of circumstances when the auditor would be asked to report on specified elements, accounts, or items of a financial statement.
b. Describe the auditor's report for an engagement where he or she audits specified elements, accounts, or items of a financial statement.

20-5 a. Under what circumstances may an auditor provide negative assurance in a compliance report related to audited financial statements?
b. What are the reporting options for conveying negative assurance in these circumstances?

[KEY TERMS

Accounting and compilation services, p. 937
Agreed-upon procedures, p. 937
Assurance services, p. 935
Audit or examination-level assurance, p. 937
Negative assurance, p. 937
No assurance, p. 937
Other comprehensive basis of accounting (OCBOA), p. 939
Special reports, p. 938
Review-level assurance, p. 937
Statements on Auditing Standards (SAS), p. 938
Statements on Standards for Accounting and Review Services (SSARS), p. 938
Statements on Standards for Attestation Engagements (SSAE), p. 938

[ACCEPTING AND PERFORMING ATTEST ENGAGEMENTS]

Audit Decision 7

■ What are the attestation standards, and how to they compare with GAAS?

In 1986, the AICPA issued the first in a new series of authoritative statements entitled **Statements on Standards for Attestation Engagements (SSAE),** which are intended to provide guidance and establish a broad framework for performing and reporting on attest services. **Attest services** are engagements in which a certified public accountant in the practice of public accounting (often referred to as the 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 (the assertion), that is the responsibility of another party.

A CPA should accept only those **attest engagements** that can be completed in accordance with the attestation standards described in the next section. In performing an attest engagement, a CPA (1) gathers evidence to support the assertion, (2) objectively assesses the measurements and communications of the individual making the assertion, and (3) reports the findings. Thus, because they are concerned primarily with the basis and support for written assertions, attest services are analytical, critical, and investigative in nature.

A variety of services do not involve attesting to the reliability of a written assertion that is the responsibility of another party. Examples of CPA services that would not be considered attest engagements include

- Management consulting engagements in which the practitioner is engaged to provide advice or recommendations to a client.
- Engagements in which the practitioner is engaged to advocate a client's position—for example, tax matters being reviewed by the Internal Revenue Service.
- Tax engagements in which a practitioner is engaged to prepare tax returns or provide tax advice.
- Engagements in which the practitioner compiles financial statements, because he or she is not required to examine or review any evidence supporting the information furnished by the client and does not express any conclusion on its reliability.
- Engagements in which the practitioner's role is solely to assist the client—for example, acting as the company accountant in preparing information other than financial statements.
- Engagements in which a practitioner is engaged to testify as an expert witness in accounting, auditing, taxation, or other matters.
- Assurance services such as CPA Risk Advisory or CPA Performance View (see pp. 965–968).

ATTESTATION STANDARDS

In an attest engagement, the CPA must meet the 11 general **attestation standards** presented in SSAE 1. These standards are shown in Figure 20-7 where they are compared with the 10 generally accepted auditing standards (GAAS) with which we are already familiar.

As the figure shows, the attestation standards, like GAAS, are classified into three categories: general, fieldwork, and reporting. Comparison of the standards in each category reveals that the attestation standards are a natural extension of GAAS to accommodate the broader array of attest services. However, several significant conceptual differences between the two sets of standards may be observed. Specifically, the attestation standards:

- Extend the attest function beyond historical financial statements. Thus, the standards omit references to financial statements and to GAAP.
- Allow the CPA to give assurances on the assertions below the level of the "positive expression of opinion" associated with the traditional financial statement audit.
- Provide for attest services tailored to the needs of specific users based on "agreed-upon procedures" and "limited-use" reports.

Figure 20-7 ■ Attestation Standards Compared with GAAS

Attestation Standards	General Accepted Auditing Standards
General Standards	
1. The engagement shall be performed by a practitioner or practitioners having adequate technical training and proficiency in the attest function.	1. The audit is to be performed by a person or persons having adequate technical training and proficiency as an auditor.
2. The engagement shall be performed by a practitioner or practitioners having adequate knowledge in the subject matter of the assertion.	
3. The practitioner shall perform the engagement only if he or she has reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.	
4. In all matters relating to the engagement, an independence in mental attitude shall be maintained by the practitioner or practitioners.	2. In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors.
5. Due professional care shall be exercised in the performance of the engagement.	3. Due professional care is to be exercised in the planning and performance of the examination and the preparation of the report
Standards of Fieldwork	
1. The work shall be adequately planned and assistants, if any, shall be properly supervised.	1. The work is to be adequately planned and assistants, if any, are to be properly supervised.
	2. A sufficient understanding of the entity and its environment, including its internal control, should be obtained to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing and extent of further audit procedures.
2. Sufficient evidence shall be obtained to provide a reasonable basis for the conclusion that is expressed in the report.	3. Sufficient competent audit evidence should be obtained through audit procedures performed to afford a reasonable basis for an opinion regarding the financial statements under audit.
Standards of Reporting	
1. The report shall identify the assertion being reported on and state the character of the engagement.	1. The report shall state whether the financial statements are presented in accordance with generally accepted accounting principles.
2. The report shall state the practitioner's conclusion about the reliability of the assertion based on the established or stated criteria against which it was measured.	2. The report shall state whether such principles have been consistently observed in the current period in relation to the preceding period.
3. The report shall state all of the practitioner's significant reservations about the engagement and the assertion.	3. Informative disclosures in the financial statements are to be regarded as reasonably adequate unless otherwise stated in the report.
4. The report shall state that the use of the report is restricted to specified parties under the following circumstances: • When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria • When the criteria used to evaluate the subject matter are available only to specified parties • When reporting on subject matter and a written assertion has not been provided by the responsible party • When the report is on an attest engagement to apply agreed-upon procedures to the subject matter.	4. The report shall either contain an expression of opinion regarding the financial statements, taken as a whole, or an assertion to the effect that an opinion cannot be expressed. When an overall opinion cannot be expressed, the reasons therefor should be stated. In all cases where an auditor's name is associated with financial statements, the report should contain a clear-cut indication of the character of the auditor's examination, if any, and the degree of responsibility he is taking.

Source: Introduction to Attestation Standards.

The two new general standards (numbers 2 and 3) establish the boundaries for attest services. This type of service is limited to engagements in which (1) the CPA has adequate knowledge of the subject matter of the assertion and (2) the assertion is capable of evaluation against criteria that are suitable to users. Though not explicitly stated in the general standards, the definition of an attest engagement given in SSAE 1 requires that the assertion be in writing.

The second standard of fieldwork under GAAS requires the auditor to obtain an understanding of internal control, however, obtaining an understanding of internal control is not applicable in all attest engagements.

The separate GAAS reporting standards pertaining to consistency and informative disclosures are encompassed, when applicable, in the second attestation standard of reporting which requires a conclusion as to whether the assertions are presented in conformity with established criteria. The fourth attestation standard of reporting explicitly acknowledges the "limited-use" attribute of many attestation reports that impose restrictions on their distribution.

ENGAGEMENTS PERFORMED UNDER ATTESTATION STANDARDS

Figure 20-8 provides a summary of engagements that a CPA can perform under Statements on Standards for Attestation Engagements (SSAEs). This figure provides an overview of the attest services and describes the levels of assurance associated with each attest service. The following discussion focuses on four of these engagements:

- SSAE 101 engagements
- Agreed-upon procedures engagements
- Prospective financial information (forecast and projections)
- Compliance attestations

The standards for reporting on internal controls for public companies are governed by PCAOB Standard No. 2, *An Audit of Internal Control over Financial Reporting Conducted in Conjunction with an Audit of Financial Statements.*

SSAE 101 ENGAGEMENTS

Early in 2000, the AICPA Assurance Services Executive Committee endorsed principles and criteria for two types of engagements, CPA **WebTrust** and CPA **SysTrust.** Both of these assurance services are designed to meet the needs expressed by decision makers for assurance about the reliability of information systems, particularly those associated with electronic commerce. Each of these services results in a report issued under SSAE 101.

CPA WebTrust

Audit Decision 8

- What are the basic principles for a WebTrust engagement?

Electronic commerce (e-commerce) grew dramatically in the last two decades. The growth of the World Wide Web has been accompanied by many businesses using the Web to conduct business, to both market and sell their products to customers. However, many consumers perceive that the risks of doing business electronically outweigh the advantages of e-commerce.

Figure 20-8 ■ Summary of Engagements Covered by Statements on Standards for Attestation Engagements

SSAE Section	Nature of Attest Engagement	Type of Assurance
101	Attest Engagements—This section sets forth attestation standards and provides guidance to a practitioner regarding general attest engagements. The standard establishes a framework for general attest engagements developed around the attestation standards explained in Figure 20-7. Two assurance services performed under SSAE 101 include WebTrust and SysTrust.	Examination Review Agreed-upon Procedures
201	Agreed-upon Procedure Engagements—This section sets forth attestation standards and provides guidance to a practitioner concerning performance and reporting in all agreed-upon procedures engagements, except those covered by other specific professional standards.	Agreed-upon Procedures
301	Financial Forecasts and Projections A **financial forecast** is a prospective financial statement that presents, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A **financial projection** is a prospective financial statement that presents, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows.	Examination Agreed-upon Procedures Compilation
401	Reporting on Pro Forma Information The objective of **pro forma financial information** is to show what the significant effects on historical financial information might have been had a consummated or proposed transaction (or event) occurred at an earlier date. Pro forma financial information is commonly used to show the effects of transactions such as a business combination, the disposition of a significant portion of the business, or a change in the form of business organization or status as an autonomous entity.	Examination Review
501	Reporting on an Entity's Internal Controls—This section provides guidance regarding: • Conditions that must be met for a practitioner to accept an engagement to examine the effectiveness of an entity's internal control; the prohibition of acceptance of an engagement to review such subject matter. • Engagements to examine the design and operating effectiveness of an entity's internal control. • Engagements to examine the design and operating effectiveness of a segment of an entity's internal control. • Engagements to examine only the suitability of design of an entity's internal control (no assertion is made about the operating effectiveness of the internal control). • Engagements to examine the design and operating effectiveness of an entity's internal control based on criteria established by a regulatory agency.	Examination
601	Compliance Attestations—This section provides guidance for engagements related to management's written assertion about either • An entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants, or • The effectiveness of an entity's internal control over compliance with specified requirements.	Examination Agreed-upon Procedures
701	Management's Discussion and Analysis—This section sets forth attestation standards and provides guidance to a practitioner concerning the performance of an attest engagement with respect to management's discussion and analysis (MD&A) prepared pursuant to the rules and regulations adopted by the Securities and Exchange Commission (SEC), which are presented in annual reports to shareholders and in other documents.	Examination Review

These risks include concerns about

- An entity's **business and information privacy practices**—that is, whether the entity discloses its business and information privacy practices for e-commerce transactions and executes transactions in accordance with its disclosed practices.
- **Transaction integrity**—that is, whether the entity maintains effective controls to provide reasonable assurance that customers' transactions using e-commerce are completed and billed as agreed.
- **Information protection**—that is, whether the entity maintains effective controls to provide reasonable assurance that the private customer information obtained as a result of e-commerce is protected from uses not related to the entity's business.

WebTrust was developed jointly by the AICPA and the Canadian Institute for Chartered Accountants (CICA) to provide assurance to e-commerce consumers about these risks.

The principles followed in a WebTrust engagement are summarized in Figure 20-9 along with example criteria. Three WebTrust principles were developed around the risks of (1) business and information privacy practices, (2) transaction integrity, and (3) information protection. In the United States a WebTrust engagement is performed as an attest engagement under SSAE 101. The WebTrust client makes an assertion about whether it met the WebTrust principles and criteria, and about its business practices, its internal controls related to executing the transaction as agreed with a customer using e-commerce, and its internal controls related to the privacy of customer information. Organizations that use the WebTrust service and seal include the American Red Cross, Baltimore Technologies, Bell Canada, and Verisign.

CPA SysTrust

Audit Decision 9

- What are the basic principles and criteria for a SysTrust engagement?

A current trend in business practices involves outsourcing services that are important to an organization but are not part of the organization's core competencies. Organizations are also entering into strategic alliances to more efficiently and effectively accomplish organizational goals. For example, many of the state CPA societies have entered into a shared-services network to develop a common database and join together many of their common backroom functions. Through this alliance, state CPA societies will be able to put together the resources to accomplish what no one could accomplish individually. As organizations enter into these alliances, partnerships, joint venture agreements, and outsourcing arrangements, they have concerns about the reliability of the data and information that they share in common. Will member data be adequately safeguarded? Does the underlying system produce reliable information to support decision making? SysTrust was developed jointly by the AICPA and the CICA to provide this level of assurance about system reliability.

Figure 20-10 summarizes the SysTrust principles and criteria. The goal is to provide the user of a SysTrust report with assurance about the overall reliability of the system used for decision making, as defined by these four characteristics. The CPA can attest to all four SysTrust principles or any one SysTrust principle.

For each principle the criteria are organized into three categories. The first is *communications,* which addresses whether the entity has defined performance

Figure 20-9 ■ WebTrust Principles

Business and Information Privacy Practices	The entity discloses its business and information privacy practices for e-commerce transactions and executes transactions in accordance with its disclosed practices.
	
	Example Criteria
	• The entity discloses descriptive information about the nature of the goods that will be shipped or the services that will be provided, including, but not limited to, the following:
	  • Condition of goods (meaning, whether they are new, used, or reconditioned).
	  • Description of services (or service contract).
	• The entity discloses the terms and conditions by which it conducts its e-commerce transactions including but not limited to the following:
	  • Time frame for completion of transactions (transaction means fulfillment of orders where goods are being sold and delivery of service where a service is being provided).
	• The entity discloses on its web site (and/or in information provided with the product) where customers can obtain warranty, repair service, and support related to the goods and services purchased on its web site.
	• The entity discloses on its web site its information privacy practices. These practices include but are not limited to the following disclosures.

Transaction Integrity	The entity maintains effective controls to provide reasonable assurance that customers' transactions using e-commerce are completed and billed as agreed.
	
	Example Criteria
	• The entity maintains controls to provide reasonable assurance that:
	  • Each request or transaction is checked for accuracy and completeness.
	  • Positive acknowledgment is received from the customer before the transaction is processed
	• The entity maintains controls to provide reasonable assurance that:
	  • Sales prices and all other costs/fees are displayed for the customer before processing the transaction.
	  • Transactions are billed and electronically settled as agreed.

Information Protection	The entity maintains effective controls to provide reasonable assurance that private customer information obtained as a result of e-commerce is protected from uses not related to the entity's business. *Example Criteria* • The entity maintains controls to protect transmissions of private customer information over the Internet from unintended recipients. • The entity maintains controls to protect private customer information obtained as a result of e-commerce and retained in its system from outsiders.

objectives, policies, and standards for each principle. The second is *procedures*, which addresses whether the entity uses procedures, people, software, data, and infrastructure to achieve each principle. The final area is *monitoring*, which addresses whether an entity monitors the system and takes actions to achieve compliance with the principles.

In the United States, a SysTrust engagement is performed as an attest engagement under either AT 101, *Attest Engagements*, or AT 201, *Agreed-Upon Procedures Engagements*. The SysTrust client makes an assertion about whether it met the SysTrust principles and criteria. In other words, management makes an assertion

Figure 20-10 ■ SysTrust Principles and Criteria

SysTrust Principles	Broad SysTrust Criteria
Availability: The system is available for operation and use at times set forth in the service-level statements or agreements.	1. The entity has defined and communicated performance objectives, policies, and standards for system availability. 2. The entity utilizes procedures, people, software, data, and infrastructure to achieve system availability objectives in accordance with established policies and standards. 3. The entity monitors the system and takes action to achieve compliance with system availability objectives, policies, and standards.
Security: The system is protected against unauthorized physical and logical access.	1. The entity has defined and communicated performance objectives, policies, and standards for system security. 2. The entity utilizes procedures, people, software, data, and infrastructure to achieve system security objectives in accordance with established policies and standards. 3. The entity monitors the system and takes action to achieve compliance with system security objectives, policies, and standards.
Integrity: Systems processing is complete, accurate, timely, and authorized.	1. The entity has defined and communicated performance objectives, policies, and standards for system processing integrity. 2. The entity utilizes procedures, people, software, data, and infrastructure to achieve system processing integrity objectives in accordance with established policies and standards. 3. The entity monitors the system and takes action to achieve compliance with system processing integrity objectives, policies, and standards.
Maintainability: The system can be updated when required in a manner that continues to provide for system availability, security, and integrity.	1. The entity has defined and communicated performance objectives, policies, and standards for system maintainability. 2. The entity utilizes procedures, people, software, data, and infrastructure to achieve system maintainability objectives in accordance with established policies and standards. 3. The entity monitors the system and takes action to achieve compliance with system maintainability objectives, policies, and standards.

Source: AICPA/CICA SysTrust™ Principles and Criteria for Systems Reliability, Version 2.0, AICPA/CICA, 2001.

about the reliability of the system in terms of availability, security, integrity, and maintainability. According to the *AICPA/CICA SysTrust Principles and Criteria for Systems Reliability, Version 2.0,* the CPA may report on either of the following:

- Management's assertion that it maintained effective controls over the reliability of the system during the period covered by the report.
- The subject matter—that is, the effectiveness of controls over the system's reliability during the period covered by the report. If one or more criteria have not been achieved, the practitioner can issue a qualified or adverse report.

However, when issuing a qualified or adverse report, the practitioner should report directly on the subject matter rather than on the assertion. Since the concept of system reliability is dynamic rather than static, SysTrust reports will always cover a historical period of time as opposed to a point in time. Although the determination of an appropriate period should be at the discretion of the CPA and the reporting entity, the AICPA/CICA report on principles and criteria suggests that reporting periods of less than three months generally would not be deemed meaningful.

AGREED-UPON PROCEDURES ENGAGEMENTS

Audit Decision 10

■ What conditions must be met in order to accept an agreed-upon procedures engagement?

The application of **agreed-upon procedures** does not constitute an audit. This type of service might occur, for example, in a proposed acquisition when the prospective purchaser asks the accountant only to reconcile bank balances and confirm the accounts receivable. AT 201, *Agreed-upon Procedure Engagements,* states that an independent accountant may accept an engagement to apply agreed-upon procedures to specified elements, accounts, or items in a financial statement under the conditions identified in Figure 20-11.

In order to ensure that all the specified parties understand the agreed-upon procedures and take responsibility for the sufficiency of those procedures, the accountant will ordinarily communicate directly with and obtain affirmative acknowledgment from each of the specified parties. The accountant's responsibility in an agreed-upon procedures engagement is to carry out the procedures and report the findings in accordance with the applicable general, fieldwork, and reporting standards.

An accountant should present the results of applying agreed-upon procedures to specific subject matter in the form of a **report of procedures and findings.** The CPA should not give negative assurance in the report of findings and should avoid vague or ambiguous language in reporting findings. Figure 20-12 provides some examples of appropriate and inappropriate descriptions of findings.

Figure 20-11 ■ Conditions for Accepting an Agreed-Upon Procedures Engagement

a. The practitioner is independent.
b. One of the following conditions is met.
   (1) The party wishing to engage the practitioner is responsible for the subject matter, or has a reasonable basis for providing a written assertion about the subject matter when the nature of the subject matter is such that a responsible party does not otherwise exist.
   (2) The party wishing to engage the practitioner is not responsible for the subject matter but is able to provide the practitioner, or have a third party who is responsible for the subject matter provide the practitioner with evidence of the third party's responsibility for the subject matter.
c. The practitioner and the specified parties agree upon the procedures performed or to be performed by the practitioner.
d. The specified parties take responsibility for the sufficiency of the agreed-upon procedures for their purposes.
e. The specific subject matter to which the procedures are to be applied is subject to reasonably consistent measurement.
f. Criteria to be used in the determination of findings are agreed upon between the practitioner and the specified parties.
g. The procedures to be applied to the specific subject matter are expected to result in reasonably consistent findings using the criteria.
h. Evidential matter related to the specific subject matter to which the procedures are applied is expected to exist to provide a reasonable basis for expressing the findings in the practitioner's report.
i. Where applicable, the practitioner and the specified parties agree on any materiality limits for reporting purposes.
j. Use of the report is restricted to the specified parties.
k. For agreed-upon procedures engagements on prospective financial information, the prospective financial statements include a summary of significant assumptions.

Figure 20-12 ■ Descriptions of Findings and Conclusions

Agreed-upon Procedures	Appropriate Description of Findings	Inappropriate Description of Findings
Inspect the shipment dates for a sample (agreed-upon) of specified shipping documents, and determine whether any such dates were subsequent to December 31, 20XX.	No shipment dates shown in the sample of shipping documents were subsequent to December 31, 20XX.	Nothing came to my attention as a result of applying that procedure.
Calculate the number of blocks of streets paved during the year ended September 30, 20XX, shown on contractors' certificates of project completion; compare the resultant number to the number in an identified chart of performance statistics.	The number of blocks of streets paved in the chart of performance statistics was Y blocks more than the number calculated from the contractors' certificates of project completion.	The number of blocks of streets paved approximated the number of blocks included in the chart of performance statistics.
Inspect the quality standards classification codes in identified performance test documents for products produced during a specified period; compare such codes to those shown in an identified computer printout.	All classification codes inspected in the identified documents were the same as those shown in the computer printout except for the following: [List all exceptions.]	All classification codes appeared to comply with such performance documents.

Source: AT 201.26.

AT 201.31 states that the accountant's report should contain the following elements:

- A title that includes the word *independent*
- Identification of the specified parties
- Identification of the subject matter (or the written assertion related thereto) and the character of the engagement
- Identification of the responsible party
- A statement that the subject matter is the responsibility of the responsible party
- A statement that the procedures performed were those agreed to by the specified parties identified in the report
- A statement that the agreed-upon procedures engagement was conducted in accordance with attestation standards established by the AICPA
- A statement that the sufficiency of the procedures is solely the responsibility of the specified parties and a disclaimer of responsibility for the sufficiency of those procedures
- A list of the procedures performed (or reference thereto) and related findings.
- Where applicable, a description of any agreed-upon materiality limits
- A statement that the practitioner was not engaged to and did not conduct an examination of the subject matter, the objective of which would be the expression of an opinion, a disclaimer of opinion on the subject matter, and a statement that if the practitioner had performed additional procedures, other matters might have come to his or her attention that would have been reported

- A statement of restrictions on the use of the report because it is intended to be used solely by the specified parties
- Where applicable, reservations or restrictions concerning procedures or findings
- Where applicable, a description of the nature of the assistance provided by a specialist
- The manual or printed signature of the practitioner's firm
- The date of the report

REPORTING ON PROSPECTIVE FINANCIAL INFORMATION

Prospective financial information is generally provided in public offerings of bonds and other securities. In addition, banks and other lending institutions often insist on projections of future earnings in extending credit to individuals and companies, and governmental agencies sometimes require forecasts in applications for grants and government contracts. To enhance the reliability of the prospective financial information, CPAs may be asked to become associated with such data.

Types of Prospective Financial Information

Audit Decision 11

- **What is the difference between a financial forecast and a projection, and what levels of assurance can be provided on prospective financial statements?**

AT 301.08 recognizes two types of **prospective financial information** as follows:

- *Financial forecast*—Prospective financial statements that present, to the best of the responsible party's knowledge and belief, an entity's expected financial position, results of operations, and cash flows. A financial forecast is based on the responsible party's assumptions reflecting the conditions it expects to exist and the course of action it expects to take. A financial forecast may be expressed in specific monetary amounts as a single-point estimate of forecasted results or as a range, where the responsible party selects key assumptions to form a range within which it reasonably expects, to the best of its knowledge and belief, the item or items subject to the assumptions to actually fall. When a forecast contains a range, the range is not selected in a biased or misleading manner, for example, a range in which one end is significantly less expected than the other.
- *Financial projection*—Prospective financial statements that present, to the best of the responsible party's knowledge and belief, given one or more hypothetical assumptions, an entity's expected financial position, results of operations, and cash flows. A financial projection is sometimes prepared to present one or more hypothetical courses of action for evaluation, as in response to a question such as, "What would happen if…?" A financial projection is based on the responsible party's assumptions reflecting conditions it expects would exist and the course of action it expects would be taken, given one or more hypothetical assumptions. A projection, like a forecast, may contain a range.

A financial forecast and a financial projection differ in terms of assumptions and the expected course of action. A forecast is based on conditions expected to exist and the course of action expected to be taken. In contrast, a projection involves one or more hypothetical courses of action. Both a forecast and a projection may be stated either as a single-point estimate or as a range. The two types of prospective financial information also differ as to use; a forecast is appropriate for general use, whereas a projection is for limited use by the entity alone or by the entity and third parties with whom the entity is negotiating directly.

A CPA may accept an engagement to perform one of three types of services pertaining to prospective financial statements when third-party use is anticipated: (1) compilation (preparation), (2) examination, and (3) application of agreed-upon procedures. The compilation does not result in the expression of any assurance (positive or negative) on the prospective statements. The other types of service constitute attestation engagements in which the CPA must satisfy the 11 attestation standards.

Examination of Prospective Financial Statements

AT 301.29 indicates that an **examination** of prospective financial statements involves (1) evaluating the preparation of the prospective financial statements, (2) evaluating the support underlying the assumptions, (3) evaluating the presentation of the prospective financial statements for conformity with AICPA presentation guidelines, and (4) issuing an examination report.

Standard Report on Prospective Financial Statements

AT 301.33 provides that the CPA's standard report on an examination of prospective financial statements should include:

- A title that includes the word *independent*
- Identification of the prospective financial statements presented
- Identification of the responsible party and a statement that the prospective financial statements are the responsibility of the responsible party
- A statement that the practitioner's responsibility is to express an opinion on the prospective financial statements based on his or her examination
- A statement that the examination of the prospective financial statements was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included such procedures as the practitioner considered necessary in the circumstances
- A statement that the practitioner believes that the examination provides a reasonable basis for his or her opinion
- The practitioner's opinion that the prospective financial statements are presented in conformity with AICPA presentation guidelines and that the underlying assumptions provide a reasonable basis for the forecast or a reasonable basis for the projection given the hypothetical assumptions
- A caveat that the prospective results may not be achieved
- A statement that the practitioner assumes no responsibility to update the report for events and circumstances occurring after the date of the report
- The manual or printed signature of the practitioner's firm
- The date of the examination report

The suggested wording of a standard report on the examination of a financial forecast is illustrated in Figure 20-13.

Departures from Standard Report

As in the case of reports on historical financial statements, other types of opinions may be expressed on prospective financial statements. The circumstances and their effects on the CPA's opinion are as follows:

Figure 20-13 ■ Standard Report on Examination of Financial Forecast

Independent Accountant's Report

We have examined the accompanying forecasted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 20XX, and for the year then ending. XYZ Company's management is responsible for the forecast. Our responsibility is to express an opinion on the forecast 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 such procedures as we considered necessary to evaluate both the assumptions used by management and the preparation and presentation of the forecast. We believe that our examination provides a reasonable basis for our opinion.

In our opinion, the accompanying forecast is presented in conformity with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants, and the underlying assumptions provide a reasonable basis for management's forecast. However, there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report.

Source: AT 301.34.

- If, in the practitioner's opinion, the prospective financial statements depart from AICPA presentation guidelines, he or she should express a qualified opinion or an adverse opinion. However, if the presentation departs from the presentation guidelines because it fails to disclose assumptions that appear to be significant, the practitioner should express an adverse opinion.
- If the practitioner believes that one or more significant assumptions do not provide a reasonable basis for the forecast, or a reasonable basis for the projection given the hypothetical assumptions, he or she should express an adverse opinion.
- If the practitioner's examination is affected by conditions that preclude application of one or more procedures he or she considers necessary in the circumstances, he or she should disclaim an opinion and describe the scope limitation in his or her report.

In each case, the report should contain an explanatory paragraph that describes the circumstances.

COMPLIANCE ATTESTATIONS

Audit Decision 12

■ What assurance can be provided in a compliance attestation performed in accordance with SSAEs?

Another area in which CPAs are increasingly being asked by regulatory bodies and others to perform additional services is in regard to an entity's **compliance with specified requirements** such as laws, regulations, contracts, rules, or grants. These requirements may be financial or nonfinancial in nature. For example, the Federal Depository Insurance Corporation Improvement Act of 1991 (FDICIA) requires certain insured depository institutions to engage independent accountants to perform agreed-upon procedures to test an institution's compliance with certain FDIC-designated "safety and soundness" laws and regulations. A nonfinancial example is the Environmental Protection Agency's (EPA) requirement that certain entities engage independent accountants to perform agreed-upon procedures regarding compliance with an EPA regulation that gasoline contain at least 2 percent oxygen.

Examination Engagements

The objective of the practitioner's examination procedures applied to an entity's compliance with specified requirements is to express an opinion on an entity's compliance, based on the specified criteria. To express such an opinion, the practitioner accumulates sufficient evidence about the entity's compliance with specified requirements, thereby restricting attestation risk to an appropriately low level. The CPA should consider attestation risk the same way he or she would consider audit risk. The attestation standards provide guidance on assessing inherent risk (including the risk of fraud), control risk, and detection risk. Furthermore, in an examination of an entity's compliance with specified requirements, the practitioner's consideration of materiality is affected by (a) the nature of the compliance requirements, which may or may not be quantifiable in monetary terms, (b) the nature and frequency of noncompliance identified with appropriate consideration of sampling risk, and (c) qualitative considerations, including the needs and expectations of the report's users. Most of the same logic that is used in an audit, including the consideration of subsequent events, applies to an examination of compliance with specified requirements.

Figure 20-14 provides an example of an examination report associated with an entity's compliance with specified requirements.

Agreed-upon Procedures Engagements

The AICPA issued *Compliance Attestation* (AT 601) to provide guidance to CPAs engaged to perform agreed-upon procedures on management's written assertions about (1) an entity's compliance with specified requirements, (2) the effectiveness of an entity's internal control over compliance (i.e., the process by which management obtains reasonable assurance of compliance with specified requirements), or

Figure 20-14 ■ Examination Report for Compliance with Specified Requirements

Independent Accountant's Report

We have examined [name of entity]'s compliance with [list specified compliance requirements] during the [period] ended [date]. Management is responsible for [name of entity]'s compliance with those requirements. Our responsibility is to express an opinion on [name of entity]'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 [name of entity]'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 [name of entity]'s compliance with specified requirements.

In our opinion, [name of entity] complied, in all material respects, with the aforementioned requirements for the year ended December 31, 20XX.

Source: AT 601.56.

(3) both. The practitioner's procedures generally may be as limited or as extensive as the specified users desire, as long as the specified users:

- Agree upon the procedures performed or to be performed, and
- Take responsibility for the sufficiency of the agreed-upon procedures for their purposes.

To reduce the risk of misunderstandings between users and independent accountants, ordinarily the practitioner should communicate directly with and obtain affirmative acknowledgment from each of the specified users.

LEARNING CHECK

20-6 a. Define an attest engagement.
b. State the three major activities involved in performing an attest engagement.

20-7 a. How are attestation standards classified?
b. Indicate the principal differences between the attestation standards and GAAS.

20-8 a. Identify six types of attest engagements that have been recognized in professional standards.
b. Indicate the levels of assurance associated with each type.

20-9 a. Briefly describe the service known as CPA WebTrust.
b. Describe three risks associated with electronic commerce that are addressed in a WebTrust engagement. How do these risks relate to the principles associated with a WebTrust engagement?
c. What professional standards apply to a WebTrust engagement?
d. Briefly describe the key components of the attest report associated with a WebTrust engagement.

20-10 a. Briefly describe the service known as CPA SysTrust.
b. Identify four broad principles associated with a SysTrust engagement.
c. Describe the three categories of criteria associated with each principle in a SysTrust engagement.
d. What professional standards apply to a SysTrust engagement?
e. Briefly describe the key components of the attest report associated with a SysTrust engagement.

20-11 a. What conditions should be met in order to accept an agreed-upon procedures engagement?
b. What should be included in a practitioner's report on agreed-upon procedures?

20-12 a. Identify and distinguish between two types of prospective financial information.
b. What matter should be covered in an accountant's examination report on prospective financial statements?
c. Describe the conditions that result in a departure from the standard report for an examination of a financial forecast. What reports should be issued in each case?

20-13 a. What conditions must be met for an independent accountant to perform an agreed-upon procedures compliance attestation?

b. Who determines the procedures in an agreed-upon procedures compliance attestation?
c. Compare and contrast a financial statement audit and an examination of a compliance attestation.

KEY TERMS

ACCOUNTING AND REVIEW SERVICES

The Statements and Standards for Accounting and Review Services (SSARSs) were first developed in 1979 at a time when CPAs could provide only two levels of assurance on financial statements. CPAs could either audit financial statements, providing reasonable assurance that the financial statements were free of material misstatement, or provide no assurance about whether the financial statements were free of material misstatements in the form of unaudited financial statements. The SSARS review service was originally developed as a lower-cost and lower-assurance alternative to an audit of the financial statements of nonpublic companies. SSARSs were developed to meet the needs of small business and the users of financial statements on nonpublic companies.

The codification of Statements on Standards for Accounting and Review Services is referred to by AR section numbers associated with accounting and review services. AR 100.04 defines **nonpublic companies** as any entity other than (a) one whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) one that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) a subsidiary, corporate joint venture, or other entity controlled by an entity covered by (a) or (b). SSARSs also provide guidance on reporting on personal financial statements and include an exemption for the preparation of personal financial statements that are included in written personal financial plans prepared by an accountant.

The following discussion focuses on two common types of engagements for nonpublic companies: a review and a compilation of financial statements. Students should also note that because these services are performed for nonpublic companies, often these engagements involve the review or compilation of OCBOA financial statements. Figure 20-15 summarizes the assurance provided by review and compilation services and the procedures that support that level of assurance. In any engagement performed under SSARS, the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should include a description of the nature and limitations of the services to be performed and a description of the report the accountant expects to render. These services are substantially less than an audit. As a result, the understanding should also provide

- That the engagement cannot be relied upon to disclose errors, fraud, or illegal acts.
- That the accountant will inform the appropriate level of management of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential.

REVIEW OF FINANCIAL STATEMENTS

Audit Decision 13

■ What procedures should be performed to support a review and a compilation of the financial statements?

The purpose of a **review engagement** of the financial statements of a nonpublic entity is to perform inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with GAAP (or OCBOA, if applicable). Figure 20-15 outlines the procedures that an accountant performs in supporting the expression of limited assurance on the financial statements.

The accountant's procedures are based primarily on inquiry and analytical procedures. The accountant should possess knowledge of the accounting principles and practices used by the industry and knowledge of the business, its organization and operating characteristics, and the nature of its assets, liabilities, revenues, and expenses that support effective use of inquiry and analytical procedures. Knowledge of the business often includes understanding the entity's products and services and important operating characteristics of the organization.

Analytical procedures are similar to those performed at the planning stages of an audit. The auditor should develop expectations considering the overall economy, the client's industry, and the client's business, before comparing actual results with expectations. Effective analytical procedures then lead to pointed inquiry about significant differences.

The accountant usually focuses on understanding the entity's strategy by making inquiries about actions taken at its board of directors meeting. Furthermore, the accountant makes inquiries of persons who have responsibility for financial and accounting matters about the entity's accounting principles and system of accounting for transactions and for developing information for the financial statements, and about such issues as changes in the entity's business activities or accounting practices or about subsequent events. Other inquiries should include:

- Unusual or complex situations that may have an effect on the financial statements.

Figure 20-15 ■ Summary of Accounting and Review Services

Review	Compilation
Assurance Express limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with GAAP (or OCBOA, if applicable).	**Assurance** Presenting in the form of financial statements information that is the representation of management without undertaking to express any assurance on the statements.
Procedures • The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates and an understanding of the entity's business that will provide him, through the performance of inquiry and analytical procedures, with 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 generally accepted accounting principles. • The accountant's understanding of the entity's business should include a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses. This would ordinarily involve a general knowledge of the entity's production, distribution, and compensation methods, types of products and services, operating locations, and material transactions with related parties. • The accountant's inquiry and analytical procedures should ordinarily consist of the following: ◦ Inquiries concerning the entity's accounting principles and practices and the methods followed in applying them. ◦ Inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements, including the status of uncorrected misstatements identified in previous engagements. ◦ Analytical procedures designed to identify relationships and individual items that appear to be unusual. The auditor should consider the general economy, the client's entire industry, and the client's company when evaluating results. ◦ Inquiries concerning actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements. ◦ Inquiries about management's knowledge about any actual or suspected fraud that could have a material effect on the financial statements. ◦ Inquiries about unusual or complex situations that may have an effect on the financial statements. ◦ Inquiries about significant transactions occurring or recognized near the end of the reporting period, and inquiries about subsequent events. ◦ Reading the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with generally accepted accounting principles. ◦ Inquiries of persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied, (2) changes in the entity's business activities or accounting principles and practices, (3) matters as to which questions have arisen in the course of applying the foregoing procedures, and (4) events subsequent to the date of the financial statements that would have a material effect on the financial statements. • The accountant is required to obtain a representation letter from members of management whom the accountant believes are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter.	**Procedures** • The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates that will enable him to compile financial statements that are appropriate in form for an entity operating in that industry. • The accountant should possess a general understanding of the nature of the entity's business transactions, the form of its accounting records, the stated qualifications of its accounting personnel, the accounting basis on which the financial statements are to be presented, and the form and content of the financial statements. • The accountant should read the compiled financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors.

- Significant transactions occurring or recognized near the end of the reporting period.
- The status of uncorrected misstatements identified during the previous engagement.
- Questions that have arisen in the course of applying the review procedures.
- Management's knowledge of any actual or suspected fraud that affects the entity and involves management or others where the fraud could have a material effect on the financial statements.
- Significant journal entries and other adjustments.
- Communications from regulatory agencies.

AR 100.30 states that a review does not contemplate obtaining an understanding of internal control or assessing control risk, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. However, if the accountant becomes aware that information coming to his or her attention is incorrect, incomplete, or otherwise unsatisfactory, he or she should perform the additional procedures he or she deems necessary to achieve 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 OCBOA.

A sample standard review report recommended in AR 100.40 is shown in Figure 20-16.

Audit Decision 14

- What language should be used for a review and a compilation report?

COMPILATION OF FINANCIAL STATEMENTS

The purpose of a **compilation engagement** is to present in the form of financial statements information that is the representation of management without undertaking to express any assurance on the statements. Many small businesses rely on

Figure 20-16 ■ Accountant's Report on SSARS Review of Financial Statements

Independent Accountant's Report

I (we) have reviewed the accompanying balance sheet of XYZ company as of December 31, 20XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of management (owners) of XYZ 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. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) 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.

Source: AR 100.40.