- 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.

assistance from their CPAs to prepare financial information for their use in either managing the company or in submitting information about the company to a bank in support of a request for financing. CPAs perform the same types of services for small businesses that a CFO or controller might perform in preparing information for management of a large company.

The compilation engagement is directed at assisting management in the preparation of financial information—not at providing assurance about whether the information is free of material misstatement. As a result, it is important for the auditor to reach an understanding with the client about the purpose of the engagement and the fact that a compilation cannot be relied upon to find errors or fraud.

The accountant's procedures associated with a compilation engagement are directed at preparing information, not providing assurance about the information. As a result, the procedures depicted in Figure 20-15 focus on the accountant's knowledge of the accounting principles and practices of the industry, and an 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. With this knowledge the accountant should assess whether the entity needs other accounting services either in connection with the compilation or as a separate service. For example, the client may need assistance from the CPA in providing various bookkeeping or data processing services, in preparing a working trial balance, or in adjusting the general ledger.

When performing a compilation, AR 100.09 states that the accountant is not required to make inquiries or perform other procedures to verify, corroborate, or review information supplied by the entity. However, the accountant may have made inquiries or performed other procedures.

The results of such inquiries or procedures, knowledge gained from prior engagements, or the financial statements on their face may cause the accountant to become aware that information supplied by the entity is incorrect, incomplete, or otherwise unsatisfactory for the purpose of compiling financial statements. In these circumstances, the accountant should obtain additional or revised information. If the entity refuses to provide additional or revised information, the accountant should consider whether modification of his or her standard report is adequate to disclose the departure, or whether he or she should withdraw from the compilation engagement.

A sample standard compilation report recommended in AR 100.14 is shown in Figure 20-17. In some cases, management may want the accountant to compile finan-

Figure 20-17 ■ Accountant's Report on Compilation of Financial Statements

I (we) have compiled 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.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Source: AR 100.14.

cial statements so that management can monitor the business, and management may decide that it does not need full disclosure financial statements for this purpose. As a result, management may ask the accountant to prepare financial statements that omit substantially all disclosures, or the statement of cash flows. When the accountant concludes that the omissions were not intended to mislead users, the only change from the standard report is the addition of the following paragraph.

> Management has elected to omit substantially all of the disclosures (and the statement of cash flows) required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operation, and cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

The above language regarding management's election to omit substantially all disclosures was developed because of the accounting profession's concern that financial statements prepared for management might also be given to bankers or other individuals outside the company. An important service for small business may involve tapping the entity's financial records electronically, preparing financial statements for management, and returning financial statements to the company electronically. When an accountant submits compiled financial statements to his or her client that are not expected to be used by a third party, The CPA may:

- Issue a standard compilation report, and
- Document an understanding with the entity through the use of an engagement letter, preferably signed by management, regarding the services to be performed and the limitations on the use of those financial statements.

LEARNING CHECK

20-14 a. What is the objective of a review engagement of the financial statements of a nonpublic entity?
b. What is involved when a CPA reviews the financial statements of a nonpublic entity?
c. Describe the accountant's report for a review of the financial statements of a nonpublic entity.

20-15 a. What is the objective of a compilation engagement regarding the financial statements of a nonpublic entity?
b. What is involved when a CPA compiles the financial statements of a nonpublic entity?
c. Describe the accountant's report for a compilation of the financial statements of a nonpublic entity that omit substantially all disclosures.

KEY TERMS

Compilation engagement, p. 961
Nonpublic companies, p. 958
Review engagement, p. 959
Statements and Standards for Accounting and Review Services (SSARS), p. 958

OTHER ASSURANCE SERVICES

Three other assurance service opportunities are discussed in the remainder of this chapter. All of the previous services represent audit or attest services covered by Statements on Auditing Standards, Statements on Standards for Attestation Engagements, or Statements on Standards for Accounting and Review Services. These remaining assurance services lie on a continuum between the attest type engagements discussed above and consulting services. The level of assurance is flexible and depends on the need of the decision maker. Figure 20-18 compares assurance services with attestation services and consulting services.

Attestation services (e.g., audits, reviews, or other attestation engagements) involve providing a written conclusion attesting to the reliability of written information that is used by third parties. There are generally three parties in the engagement: the party preparing the information and determining the informa-

Figure 20-18 ■ Comparison of Attestation, Assurance, and Consulting Services

	Attestation	Assurance	Consulting
Result	Written conclusion about the reliability of the written assertions of another party	Better information for decision makers. Recommendations might be a by-product.	Recommendations based on the objectives of the engagement
Objective	Reliable information	Better decision making	Better outcomes
Parties to the engagement	Not specified, but generally three (the third party is usually external); CPA generally paid by the preparer	Generally three (although the preparer and user might be employed by the same entity); CPA paid by the preparer or user	Generally two; CPA paid by the user
Independence	Required by standards	Included in definition	Not required
Substance of CPA output	Conformity with established or stated criteria	Assurance about reliability or relevance of information. Criteria might be established, stated, or unstated	Recommendations; not measured against formal criteria
Form of CPA output	Written	Some form of communication	Written or oral
Critical information developed by	Asserter	Either CPA or asserter	CPA
Information content determined by	Preparer (client)	Preparer, CPA, or user	CPA
Level of assurance	Examination, review, or agreed-upon procedures	Flexible; for example, it might be compilation level, explicit assurance about usefulness of the information for intended purpose, or implicit from the CPA's involvement	No explicit assurance

tion content, the party using the information, and the CPA. Independence is required by standards such as GAAS or attestation standards, and the CPA prepares a written report expressing his or her conclusions.

At the other end of the spectrum, a consulting engagement is generally a two-party engagement between the CPA and his or her client. The objective of the consulting engagement is to improve organizational outcomes. Each engagement is custom made, and the CPA determines the information content of his or her report in a consulting engagement. Independence is not required, no explicit assurance is provided, and reports may be written or oral. The recommendations in a consulting engagement are not measured against established criteria such as GAAP, OCBOA, or the COSO standards on internal controls.

Assurance services lie along the spectrum between attestation engagements and consulting engagements. As stated earlier, the goal of assurance services is better decision making. When working to improve information for decision makers, the CPA will likely focus on improving the relevance of information, not just its reliability. The criteria used for the engagement will usually be tailored to the decision maker rather than using a one-size-fits-all criterion such as GAAP or OCBOA. Assurance engagements are more flexible than attest engagements; information may be developed by either the CPA or by an entity making an assertion; and the content of information may be determined by either the CPA, the preparer, or the user. The CPA provides an independent conclusion about information. A written report, however, is not required.

Two assurance opportunities discussed in the remainder of the chapter, CPA Risk Advisory and CPA Performance View, represent natural extensions of the financial statement audit. They are also grounded in research supporting the demand for these services, particularly by senior management and the board of directors. The final assurance service discussed in the chapter, CPA ElderCare, might be an extension of tax and financial planning services offered by CPAs.

CPA RISK ADVISORY

Audit Decision 15

■ What are the types of services that might be performed as part of a CPA Risk Advisory engagement?

Recall from Chapter 7 that the auditor should understand an entity's objectives, strategies, and related business risks. **Business risks** result from significant conditions, events, circumstances, or actions that could adversely affect the entity's ability to achieve its objectives and execute its strategies. **CPA Risk Advisory** is an assurance engagement on business risk assessment that might include any of the following types of services:

- Identification and assessment of primary potential risks faced by a business or entity
- Independent assessment of risks identified by an entity
- Evaluation of an entity's systems for identifying and limiting risks

Hence, the nature of the CPA service depends on the risk assessment practices that exist within the entity. The foundation for any of these services is the knowledge about an entity's objectives, strategies, and related business risks obtained while performing the audit, and the decision maker's needs.

Organizations that manage risk well are more likely to achieve or exceed their objectives because they have the capacity and ability to, (1) identify and exploit opportunities, (2) identify and manage risks that could affect achieving their objectives, (3) make good decisions quickly, and (4) respond and adapt to unexpected events. Successful organizations take calculated risks to achieve objectives. They weigh opportunities against threats and act decisively. The traditional, negative definitions of risk—harm, loss, danger, and hazard—are only part of the story. The other and equally important part is opportunity.

Although each organization has its own unique approach to risk management, a number of consistent steps have emerged and represent current best practice.

- Establish the context.
- Identify risks.
- Analyze and assess risks.
- Design strategies for managing risk.
- Implement and integrate risk management.
- Measure, monitor, and report.

These steps can be applied to an entire enterprise, to part of the organization, or to a specific project. Although an enterprisewide program is the most effective, there is considerable value in beginning in a local or limited way.

The decision makers involved in a CPA Risk Advisory service are likely to be management and the board of directors, charged with oversight of the entity's operation and who need to consider the risks faced by the entity. Understanding an entity's business risk is a particularly important part of the strategic planning process for an entity. When the audit client is a small business, the owner–manager often seeks auditors with industry experience so that he or she might tap the CPA's knowledge of how to improve the business. In other words, the owner–manager is seeking the CPA's opinion on how to better manage the entity's business risks. Often, the board of directors, which has less day-to-day experience working with an entity, would like assurance about the entity's business risks because this service might provide leading indicators of an entity's eventual financial performance.

The auditor likely obtains knowledge of each of these risks while performing the financial statement audit. For example, the auditor might obtain knowledge about strategic environment risks associated with changes in customers' tastes and preferences or changes in the competitive environment when auditing the revenue and production cycles. The auditor often obtains knowledge of the risk of adverse changes in the market for the client's products in order to evaluate the net realizable value of the client's inventory. The auditor might obtain knowledge about operating environment risks related to inefficient business practices when auditing the production cycle. The auditor might obtain knowledge about information risks associated with poor-quality financial information when gaining an understanding of the entity's system of internal control. Finally, the auditor also considers these types of risks when evaluating whether an entity is likely to continue as a going concern. Understanding the client's business risks is important to making audit judgments regarding accounting estimates and evaluating the reasonableness of the entity's profitability. Hence, risk assessment services are a natural extension of the financial statement audit.

When performing such services, the independent auditor should be careful to maintain an advisory role. The independent CPA should not make management decisions or take other actions that would impair independence.

CPA PERFORMANCE VIEW

Audit Decision 16

■ What are the types of services that might be performed as part of a CPA Performance View engagement?

CPA Performance View is the AICPA's branded version of performance measurement. The AICPA has recognized performance measurement as a growing area that is well suited to the skill sets of CPAs, and builds on knowledge obtained during an audit. The purpose of a CPA Performance View engagement is to provide assurance regarding an organization's use of both financial and nonfinancial measures to evaluate the effectiveness and efficiency of its activities. These performance measures can be used for assessing performance at any level within an organization, or for assessing the performance of the entity as a whole. Performance measures can also be used to evaluate how the organization is performing in relation to others in the same industry.

The report of the AICPA Special Committee on Assurance Services discusses a spectrum of services that CPAs can provide. Each service could be performed as a separate engagement, or several could be combined into one engagement. The potential services are as follows:

For Organizations that Have Performance Measurement Systems

- Assessing the reliability of information being reported from the organization's performance measurement system.
- Assessing the relevance of the performance measures (that is, how well they inform management about achievement of the performance objectives they have set).

For Organizations that Do Not Have Performance Measurement Systems

- Identifying relevant performance measures.

For All Organizations

- Providing advice on how the organization can improve its performance measurement system and its actual results.

Potential users of CPA Performance View might include senior management and the board of directors. Senior management might use these services to: (1) assess whether their systems are properly measuring activities that are relevant to and consistent with their strategic objectives, (2) evaluate their employees, (3) measure actual performance against their objectives, or (4) identify those activities, processes, or functions that provide the best opportunities for improvement in performance. The board of directors might use this service to assist them with their oversight responsibilities.

Many organizations track their success based solely on past financial performance. Although an organization's history is an excellent way to see where it has been, it does not say much about where it is going. If a company earned $250,000 or $2 billion last year, what in the financial statements leads you to believe it will accomplish the same or better next year? Traditional performance tracking methods focus on sales, net income, gross margin, return on assets, asset turnover, and so on, but do not provide the needed information to anticipate the future. It is great news that gross margins are remaining high or increasing, but if customers are unhappy with service and are switching to competitors, what good is the information about margins? Although financial

Figure 20-19 ■ The Balanced Scorecard Approach to Performance Measurement

Customer Perspective

Example Goals	*Example Meausres*
• Product quality	• Measure of warranty claims • Summary of product evaluation by independent rating agencies
• Customer Satisfaction	• Measure of on-time delivery • Customer satisfaction surveys
• New Customer Acquisition	• Report of new customers ranked by volume of activity or gross profit margins

Internal Perspective

Example Goals	*Example Measures*
• Manufacturing efficiency	• Product cycle time
• Manufacturing effectiveness	• Defects per million
• Service effectiveness	• Transaction requests not fulfilled

Innovation Perspective

Example Goals	*Example Measures*
• Product innovation	• Percent of revenues from new products • Number of suggestions made and implemented

Financial Perspective

Example Goals	*Example Measures*
• Revenue goals	• Revenues by product mix
• Overall financial goals	• Return on investment • Cash flow generation

measures provide an accurate and detailed history, they do not provide guidance for the future.

CPA Performance View is a system that merges the standard financial measures with leading indicators, such as customer satisfaction, employee training and satisfaction, product quality, sales calls, and proposals delivered. By joining the two, an entity will have the ability to identify critical decision points that can lead to organizational change and better performance.

The balanced scorecard system suggested by Kaplan and Norton[1] has received considerable attention as an alternative system of performance measures. Under the balanced scorecard approach, an entity develops goals in each of four areas: (1) the customer perspective, (2) the internal perspective, (3) the innovation perspective, and (4) the financial perspective. It then develops performance measures relevant to its goals. Figure 20-19 provides some examples of how an organization might set goals and develop internal measures that are associated with those goals.

[1] Robert S. Kaplan and David P. Norton, *The Balanced Scorecard—Translating Strategy into Action* (Boston, MA: Harvard Business School Press, 1996).

CPA ELDERCARE

Audit Decision 17

■ What are the types of services that might be performed as part of a CPA ElderCare engagement?

The purpose of a **CPA ElderCare** engagement is to assure family members that elderly relatives no longer able to be totally independent are receiving the type of care they need. CPA ElderCare (ElderCare) might result in three different types of engagements.

1. *Attestation engagements,* such as a compliance attestation where the CPA performs tests of a health care facility's assertion that it complied with stated regulations or policies in accordance with AT 601, *Compliance Attestations.* Alternatively, the CPA might perform an agreed-upon procedure attestation where the CPA issues a report of procedures and findings associated with the measurable care-giving performance (AT 201, *Agreed-Upon Procedure Engagements*). An attest service might also include a review of the financial performance of a trust in accordance with AR 100, *Compilation and Review of Financial Statements.*
2. *Direct services,* such as paying bills for elderly individuals or ensuring that expected revenues are received in the process of managing an elderly individual's checking account. Performing direct services for an elderly client may impair independence associated with other services for that client.
3. *Consulting Services,* such as assisting the elderly or their families in determining the range of housing and care alternatives. Consulting services might also include performing such services as helping a family member monitor care or financial services such as estate planning or establishing a trusteeship. Figure 20-20 provides a listing of possible services that could be provided under the umbrella of an ElderCare engagement. The customer, or decision maker, of ElderCare services may be either an elderly individual who needs some form of assistance or care, or the family of an elderly individual who would like periodic reports on the care of an elderly relative.

The AICPA Special Committee on Assurance Services stated that one of the megatrends that will continue to affect the United States is the aging of the population. The Report of the AICPA Special Committee on Assurance Services reads as follows:

> The U.S. Bureau of the Census estimates that by the year 2000 16.6 million people in the United States will be 75 years of age or older; approximately 4.3 million people in the United States will be aged 85 and over. Many of these people will be widows who did not handle finances while their spouses were living. It is also estimated that persons age 65 and over controlled between $11 trillion and $13 trillion of wealth. Increasingly, people are living to ages where assistance is needed in remaining in their own homes or for institutional care. In the past, they normally relied on members of their families, many of whom lived close by, for this assistance. But now, younger adults often find it necessary for both spouses to work outside the home to provide an acceptable standard of living. As a result, the younger generation does not have the time available to care for aging parents. And as our society has become mobile in following job opportunities, many family members now live far away from their elders as the latter begin to require care and assistance.

The knowledge and experience that an auditor brings in performing a variety of audit and attestation engagements lend instant credibility to these new services. Auditors are skilled in evaluating financial and nonfinancial assertions and have experience in using experts, when necessary, to ensure that appropriate evidence is

Figure 20-20 ■ CPA ElderCare Services

Assurance Services

Financial

- Review and report on financial transactions
- Test for asserter's adherence to established criteria
- Review investments and trust activity
- Audit third-party calculations, such as pension, insurance, and annuity payouts
- Review reports from fiduciaries

Nonfinancial

- Measure and report on care provider performance against established goals
- Evaluate and report on the performance of other outside parties, such as contractors

Direct Services

Financial

- Receive, deposit, and account for client receipts
- Ensure expected revenues are received
- Make appropriate disbursements
- Submit claims to insurance companies
- Confirm accuracy of provider bills and appropriate reimbursements
- Protect the elderly by controlling the checkbook and other assets
- Provide income tax planning and return preparation
- Provide gift tax return preparation
- Prepare employment tax returns for caregivers and other household help

Nonfinancial

- Arrange for transportation, housekeeping, and other services
- Manage real estate and other property
- Visit and report on elderly on behalf of children in distant locations

Consulting Service

Financial

ElderCare Planning for

- Housing and support service needs
- Declining competency
- Death or disability of one or both spouses
- Alternative costs of retirement communities and other housing
- Housing and care alternatives
- Services available in the community
- Estate planning

Fiduciary planning for

- Financial power of attorney
- Health care power of attorney
- Guardianship
- Trusteeship
- Living wills
- Advanced medical directives

Evaluation of health care financing options for

- Medicare and Medicaid
- LTC insurance
- Medigap insurance
- HMOs
- Annuities
- Viatical insurance settlements
- Reverse mortgages
- Sales/leaseback of home
- Flexible spending accounts

Nonfinancial

Family facilitation

- Mediate/arbitrate family disputes
- Provide objectivity for highly emotional issues
- Act as a "go-between" between parent and child

Coordination of support and health care services

- Lead a team of health care, legal, and other professionals

Other consulting services

- Help family monitor care
- Establish standards of care expected
- Communicate expectations to care providers
- Establish performance measurement systems

Source: Karen Duggan, George Lewis, and Ann Elizabeth Sammon, "Opportunity Knocks: CPA ElderCare Services," *Journal of Accountancy*, December 1999, pp. 43–51.

obtained to support the auditor's expression of assurance. In some cases, the CPA may coordinate a team that includes other professionals such as geriatric care managers or social workers. When performing attestation services, the auditor needs to ensure that he or she has followed relevant professional standards and is independent.

The CPA who performs direct services for the client will often not be independent by the nature of the engagement. Nevertheless, this may be the best way to serve the decision-making needs of the elderly, or their family, who need the direct services of a trusted individual. CPAs who perform tax and personal financial planning services might be ideally positioned to assist clients who need these direct services.

LEARNING CHECK

20-16 a. Describe the purpose of a risk assessment engagement. Who are the most likely customers of a risk assessment engagement?
b. Identify three major types of services associated with a risk assessment engagement.
c. Identify a useful way to categorize business risks.
d. Describe activities performed in the financial statement audit that prepare auditors for performing a business risk engagement.

20-17 a. Describe the purpose of a performance measurement engagement. Who are the most likely customers of a performance measurement engagement?
b. Identify several services that a CPA might offer in a performance measurement engagement.
c. What are the elements of the balanced scorecard? Give an example of each.
d. Describe activities performed in the financial statement audit that prepare auditors for performance measurement engagement.

20-18 a. Describe the purpose of a CPA ElderCare engagement. Who are the most likely customers of a CPA ElderCare engagement?
b. Describe three types of services that might be performed as part of a CPA ElderCare engagement. Provide an example of each.
c. Describe an important trend that motivates the need for CPA ElderCare engagements.

KEY TERMS

Business risks, p. 965
CPA ElderCare, p. 969
CPA Performance View, p. 967
CPA Risk Advisory, p. 965

FOCUS ON AUDIT DECISIONS

This chapter focuses on a variety of services that represent an extension of the basic audit service. Figure 20-21 summarizes the audit decisions discussed in Chapter 20 and provides page references indicating where these decisions are discussed in more detail.

Figure 20-21 ■ Summary of Audit Decisions Discussed in Chapter 20

Audit Decision	Factors that Influence the Audit Decision	Chapter References
D1. What opinions can be used in an audit of the basic financial statements?	This is primarily covered in Chapter 2. See Figures 20-2 and 2-4.	pp. 935–936
D2. What are the primary options in terms of level of service that might be available for an attest engagement?	• Audit or examination level of assurance (reasonable assurance) • Review-level assurance (negative assurance) • Agreed-upon procedures assurance • No assurance	pp. 937–938
D3. What are the professional standards that cover most audit and attest engagements?	• Statements on Auditing Standards • Statements on Standards for Attestation Engagements • Statements on Standards for Accounting and Review Services	p. 938
D4. Under what circumstances can an auditor audit and report on financial statements prepared in accordance with an other comprehensive basis of accounting?	GAAS recognizes four comprehensive bases of accounting other than GAAP: • A basis used to comply with the requirements of a regulatory agency • A basis used to file the entity's income tax return • The cash receipts and disbursements basis of accounting • A basis that uses a definite set of criteria with substantial support such as the price-level basis of accounting	pp. 939–940
D5. Under what circumstances can an auditor audit and report on an individual element, account, or item of the financial statements?	An auditor is not limited to auditing the entire financial statements. An engagement to express an opinion on specified elements, accounts, or items may be made in conjunction with the audit of the financial statements or as a separate engagement. However, the report should include language that limits the use of the report to those who specifically need and understand the purpose of the engagement.	pp. 940–942
D6. Under what circumstances can an auditor audit and report on compliance with contractual agreements?	When an auditor audits the financial statements as a whole, the auditor may also provide review-level assurance that nothing came to the auditor's attention that led the firm to believe that the company was not in compliance with a contractual agreement.	p. 942
D7. What are the attestation standards, and how do they compare with GAAS?	Figure 20-7 identifies the five general standards, two fieldwork standards, and four reporting standards and compares them with GAAS.	pp. 943–947
D8. What are the basic criteria for a WebTrust engagement?	A WebTrust engagement addresses the risk associated with (1) business and information privacy practices, (2) transaction integrity, and (3) information protection.	pp. 946–948
D9. What are the basic principles and criteria for a SysTrust engagement?	A SysTrust engagement addresses four basic principles: (1) system availability, (2) system security, (3) system integrity, and (4) system maintainability. Each principle is organized into three criteria: communications, procedures, and monitoring.	pp. 948–951
D10. What conditions must be met in order to accept an agreed-upon procedures engagement?	The assurance provided by an agreed-upon procedures engagement depends on the procedures performed. As a result, Figure 20-11 outlines 11 conditions that are important to the acceptance of an agreed-upon procedures engagement.	pp. 951–953

(continues)

Figure 20-21 ■ (Continued)

Audit Decision	Factors that Influence the Audit Decision	Chapter References
D11: What is the difference between a financial forecast and a projection, and what levels of assurance can be provided on prospective financial statements?	A financial forecast represents an entity's best estimate of financial position, results of operations, and cash flows. A financial projection represents the financial position, results of operations, and cash flows that result from given hypothetical assumptions. A projection is a "what if" scenario. An auditor may provide examination, agreed-upon procedures, or compilation-level assurance (no assurance) on a forecast or projection.	pp. 953–955
D12. What assurance can be provided in a compliance attestation performed in accordance with SSAEs?	An auditor can audit compliance with laws, regulations, grants, or contracts under the Statements on Standards for Attestation Engagements. An auditor can provide either examination-level assurance or agreed-upon procedures assurance.	pp. 955–957
D13. What procedures should be performed to support a review and a compilation of the financial statements?	Figure 20-15 outlines the procedures required in both a compilation and a review engagement under Statements on Standards for Accounting and Review Services.	pp. 958–961
D14. What language should be used for a review and a compilation report?	Figure 20-16 provides an example review report, and Figure 20-17 provides an example compilation report.	pp. 961–963
D15. What are the types of services that might be performed as part of a CPA Risk Advisory engagement?	CPA Risk Advisory is an assurance engagement on business risk assessment that might include any of the following types of services: • Identification and assessment of primary potential risks faced by a business or entity • Independent assessment of risks identified by an entity • Evaluation of an entity's systems for identifying and limiting risks	pp. 963–966
D16. What are the types of services that might be performed as part of a CPA Performance View engagement?	The potential services in a CPA Performance View Engagement include: *For Organizations that Have Performance Measurement Systems* • Assessing the reliability of information being reported from the organization's performance measurement system. • Assessing the relevance of the performance measures (that is, how well they inform management about achievement of the performance objectives they have set). *For Organizations that Do Not Have Performance Measurement Systems* • Identifying relevant performance measures. *For All Organizations* • Providing advice on how the organization can improve its performance measurement system and its actual results.	pp. 967–968
D17. What are the types of services that might be performed as part of a CPA ElderCare engagement?	The purpose of a CPA ElderCare engagement is to assure family members that elderly relatives no longer able to be totally independent are receiving the type of care and services they need. Figure 20-20 provides examples of a wide range of ElderCare services.	pp. 969–971

objective questions

Objective questions are available for the student at www.wiley.com/college/boynton

comprehensive questions

20-19 **(Special reports)** Jiffy Clerical Services is a corporation that furnishes temporary office help to its customers. Billings are rendered monthly based on predetermined hourly rates. You have examined the company's financial statements for several years. Following is an abbreviated statement of assets and liabilities on the modified cash basis as of December 31, 20X0:

Assets	
Cash	$ 20,000
Advances to employees	$ 1,000
Equipment and autos, less accumulated deprecation	$ 25,000
Total assets	$ 46,000
Liabilities	
Employees' payroll taxes withheld	$ 8,000
Bank loan payable	$ 10,000
Estimated income taxes on cash basis profits	$ 10,000
Total liabilities	$ 28,000
Net Assets	$ 18,000
Represented by	
Common stock	$ 3,000
Cash profits retained in the business	$ 15,000
	$ 18,000

Unrecorded receivables were $55,000 and payables were $30,000.

Required

a. Prepare the report you would issue covering the statement of assets and liabilities as of December 31, 20X0, as summarized above, and the related statements of cash revenue and expenses for the year ended that date.

b. Briefly discuss and justify your modifications of the conventional report on accrual basis statements.

20-20 **(Special reports)** Young and Young, CPAs, completed an audit of the financial statements of XYZ Company, Inc., for the year ended June 30, 20X3, and issued a standard unqualified auditor's report dated August 15, 20X3. At the time of the engagement, the board of directors of XYZ requested a special report attesting to the adequacy of the provision for federal and state income taxes and the related accruals and deferred income taxes as presented in the June 30, 20X3, financial statements.

Young and Young submitted the appropriate special report on August 22, 20X3.

Required

Prepare the special report that Young and Young should have submitted to XYZ Company, Inc.

AICPA

20-21 **(Compliance report based on audit)** In addition to examining the financial statements of the ABC Company at December 31, 20X0, the auditor agrees to review the loan agreement dated July 1, 20X0, with the Main Street Bank to determine whether the borrower is complying with the terms, provisions, and requirements of sections 14 to 30 inclusive. The auditor finds that the ABC Company is in full compliance with the loan agreement.

Required

a. Prepare a report on compliance with contractual provisions, assuming it is to be a separate report.

b. Indicate how the report on compliance would differ if it were included as part of the auditor's report on the financial statements.

20-22 **(WebTrust)** One of your clients, Green Golf, Inc., is a retailer of golf equipment. Over the last five years 50 percent of the company's business, and most of the company's growth, have come from a shift from retail store sales to catalogue sales. The company has established a web site for business-to-customer transactions, yet the customer response has reached only about 30 percent of projected sales. You are aware of your client's frustrations in carving out an electronic commerce market presence, and you and your audit manager have arranged a lunch with the client to discuss WebTrust.

Required

a. Describe how a WebTrust engagement might benefit your client in his efforts to expand his use of electronic commerce in the business-to-consumer environment.

b. What assurance must your client be prepared to offer the consumer as part of a WebTrust engagement?

c. If your client is making a statement to the public about his electronic commerce practices, why does he need a report from his CPAs about those practices?

d. Describe the inherent limitations involved in a WebTrust engagement.

20-23 **(SysTrust)** During a recent staff training session the audit partners, managers, seniors, and staff were discussing the new assurance service opportunity associated with SysTrust. Your client base includes specializations in small manufacturing companies that do outsourcing work for the auto industry, retailers, and financial institutions with trust departments. Answer the following questions that are raised during the discussion.

Required

a. What clients are most likely to be interested in a SysTrust engagement? Describe how decision makers would benefit from a SysTrust engagement.

b. What specific assurances are provided by a company that hires a CPA to attest to its assertions about SysTrust principles and criteria?

c. Assume that your CPA firm sells time on your accounting system to your small-business clients where they can log onto your system and maintain their own general ledger. Can you offer your clients a SysTrust report on the reliability of your general ledger system that you make available for their use?

20-24 **(Agreed-upon procedures)** Health Equipment Company (HEC) has acquired the rights to manufacture and sell certain health diagnostic equipment in the 13 Eastern states from Human Diagnostic, Inc., in exchange for paying a 15 to 25 percent royalty on the machinery sold, depending on the type of equipment sold. The contract allows Human Diagnostics, Inc. (HDI) to come in and audit royalties paid at any time. In the third year of the contact HDI was concerned that they had not received adequate royalties, so they hired Fred Fastfoot, CPA, to audit royalties paid. At Fred Fastfoot's suggestion, HDI signed an engagement letter to have Fred perform an agreed-upon procedures engagement, and the engagement letter outlined the procedures to be performed. Upon obtaining a signed engagement letter from HDI, Fred wrote HEC asking for information to allow him to perform an agreed-upon procedures engagement.

After three weeks Fred had received no information from HEC. Fred send a second request and threatened to turn the matter over to HDI's attorney if the information was not received. A week later partial information arrived. HEC also stated that it felt that some of the information requested was outside the scope of the contract. Fred was able to perform some of the agreed-upon procedures but not others. Advocating for HDI's position, Fred send a third request to HEC only to receive a reply from HEC that it did not feel that the information was relevant to the scope of the contract. After discussions with HDI, Fred turned over all the information that he received from HEC to HDI. At the same time, HDI asked Fred to discontinue the engagement and HDI proceeded to bring litigation against HEC.

Required

Identify the inappropriate actions of Fred Fastfoot, CPA, and indicate what Fred should have done to avoid each inappropriate action. Organize your answer sheet as follows:

INAPPROPRIATE ACTION	WHAT FRED SHOULD HAVE DONE TO AVOID INAPPROPRIATE ACTION

20-25 **(Reporting on prospective financial statements)** Clients sometimes call on an accountant to report on or assemble prospective financial statements for use by third parties.

Required

a. 1. Identify the types of engagements that an accountant may perform under these circumstances.
   2. Explain the difference between "general use" and "limited use" of prospective financial statements.
   3. Explain what types of prospective financial statements are appropriate for "general use" and what types are appropriate for "limited use."

b. Describe the contents of the accountant's standard report on a compilation of a financial projection.

AICPA

20-26 **(Situations involving unaudited, compiled, or reviewed financial statements)** The limitations of the CPA's professional responsibilities when he or she is associated with unaudited financial statements are often misunderstood. These misunderstandings can be substantially reduced by carefully following professional pronouncements in the course of the work and taking other appropriate measures.

Required

The following list describes seven situations the CPA may encounter or contentions he or she may have to deal with in the association with and preparation of unaudited financial statements. Briefly discuss the extent of the CPA's responsibilities and, if appropriate, the actions that should be taken to minimize any misunderstandings. Number your answers to correspond with the numbering in the following list.

1. The CPA was engaged by telephone to perform write-up work including the preparation of financial statements. The client believes that the CPA has been engaged to audit the financial statements and examine the records accordingly.
2. A group of businessmen who own a farm that is managed by an independent agent engage a CPA to prepare quarterly unaudited financial statements for them. The CPA prepares the financial statements from information given by the independent agent. Subsequently, the businessmen find the statements were inaccurate because their independent agent was embezzling funds. The businessmen refuse to pay the CPA's fee and blame the CPA for allowing the situation to go undetected, contending that the CPA should not have relied on representations from the independent agent.
3. In comparing the trial balance with the general ledger, the CPA finds an account labeled "audit fees" in which the client has accumulated the CPA's quarterly billings for accounting services, including the preparation of quarterly unaudited financial statements.
4. Unaudited financial statements were accompanied by the following letter of transmittal from the CPA: We are enclosing your company's balance sheet as of June 30, 20X0, and the related statements of income and retained earnings and cash flows for the six months then ended that we have reviewed.
5. To determine appropriate account classification, the CPA reviewed a number of the client's invoices. The CPA noted in the working papers that some invoices were missing but did nothing further because the CPA felt they did not affect the unaudited financial statements he or she was preparing. When the client subsequently discovered that invoices were missing, the client contended that the CPA should not have ignored the missing invoices when preparing the financial statements and had a responsibility to at least inform the client that they were missing.
6. The CPA has prepared a draft of unaudited financial statements from the client's records. While reviewing this draft with the client, the CPA learns that the land and building were recorded at appraisal value.
7. The CPA is engaged to review, but not audit, the financial statements prepared by the client's controller. During this review, the CPA learns of several items that by Generally Accepted Accounting Principles would require adjustment of the statements and footnote disclosures. The controller agrees to make the recommended adjustments to the statements but says that he or she is not going to add the footnotes because the statements are unaudited.

AICPA

20-27 **(Compilation and review engagements)** Ann Martin, CPA, has been asked by Harry Adams, owner of Adams Cleaners, to prepare the company's annual financial statements from the company's records. Adams, who is unfamiliar with the services of a CPA, also requests Ms. Martin to add as much prestige to the statements as possible in the form of an opinion or some type of assurance.

Required

a. Explain the nature and limitations of an engagement to compile financial statements.

b. Write the accountant's report on a compilation of financial statements.

c. Explain the type of assurance that may be given if Martin is engaged to review Adams's financial statements.

d. Explain why an opinion cannot be expressed.

20-28 **(Evaluate compilation report)** The following report was drafted on October 25, 20X0, by Major, CPA, at the completion of the engagement to compile the financial statements of Ajax Company for the year ended September 30, 20X0. Ajax is a nonpublic entity in which Major's child has a material direct financial interest. Ajax decided to omit substantially all of the disclosures required by generally accepted accounting principles because the financial statements will be for management's use only. The statement of cash flows was also omitted because management does not believe it to be a useful financial statement.

> To the Board of Directors of Ajax Company:
>
> I have compiled the accompanying financial statements of Ajax Company as of September 30, 20X0, and for the year then ended. I planned and performed the compilation to obtain limited assurance about whether the financial statements are free of material misstatements.
>
> A compilation is limited to presenting information in the form of financial statements. 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. I have not audited the accompanying financial statements and, accordingly, do not express any opinion on them.
>
> Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's financial position, results of operations, and changes in financial position.
>
> I am not independent with respect to Ajax Company. This lack of independence is due to my child's ownership of a material direct financial interest in Ajax Company.
>
> This report is intended solely for the information and use of the Board of Directors and management of Ajax Company and should not be used for any other purpose.
>
> Major, CPA

Required

Identify the deficiencies contained in Major's report on the compiled financial statements. Group the deficiencies by paragraph where applicable. Do not redraft the report.

20-29 **(Business risk assessment)** You have just acquired a new small-business client that dominates the retail marketplace for high-end stereo and television equipment in three small, but growing, communities. The business also works closely with several local builders and sells a service where it installs audio equipment in new homes. The long-time owner of the company has just retired, and his daughter has recently taken the reins as owner–manager. She is considering how to expand the business. In particular, she is looking into business opportunities to open stores in larger markets, as growth is limited by community size in the current locations.

Required

a. Describe the nature of a risk assessment service that you could offer the new owner–manager as she develops a plan to expand the business.

b. Explain the competitive advantages you bring to a risk assessment engagement as a CPA and the company's auditor.

c. It is often useful to categorize business risk into three categories: (1) strategic environment risks, (2) operating environment risks, and (3) information risks. For each category identify two specific risks that the new owner–manager should consider in the context of opening a new store in a larger market. Also identify a service you can perform to assist the owner–manager with these risks without violating AICPA independence rules for this nonpublic company. Use the following format.

RISK IDENTIFICATION	SERVICE TO ASSIST CLIENT
Strategic environment risk	Describe service to assist client
•	•
•	•
Operating environment risk	Describe service to assist client
•	•
•	•
Information risk	Describe service to assist client
•	•
•	•

case

20-30 **(Evaluate compilation engagement performance)** Brown, CPA, received a telephone call from Calhoun, the sole owner and manager of a small corporation. Calhoun asked Brown to prepare the financial statements for the corporation and told Brown that the statements were needed in two weeks for external financing purposes. Calhoun was vague when Brown inquired about the intended use of the statements. Brown was convinced that Calhoun thought Brown's work would constitute an audit. To avoid confusion, Brown decided not to explain to Calhoun that the engagement would only be to prepare the financial statements. Brown, with the understanding that a substantial fee would be paid if the work were completed in two weeks, accepted the engagement and started the work at once.

During the course of the work, Brown discovered an accrued expense account labeled "professional fees" and learned that the balance in the account represented an accrual for the cost of Brown's services. Brown suggested to Calhoun's bookkeeper that the account name be changed to "fees for limited audit engagement." Brown also reviewed several invoices to determine whether accounts were being properly classified. Some of the invoices were missing. Brown listed the missing invoice numbers in the working papers with a note indicating that there should be a followup on the next engagement. Brown also discovered that the available records included the fixed asset values at estimated current replacement costs. Based on the records available, Brown prepared a balance sheet, income statement, and statements of stockholders' equity. In addition, Brown drafted the footnotes but decided that any mention of the replacement costs would only mislead the readers. Brown suggested to Calhoun that readers of the financial statements would be better informed if they received a separate letter from Calhoun explaining the meaning and effect of the estimated replacement costs of the fixed assets. Brown mailed the financial statements and footnotes to Calhoun with the following note included on each page:

The accompanying financial statements are submitted to you without complete audit verification.

Required

Identify the inappropriate actions of Brown and indicate what Brown should have done to avoid each inappropriate action. Organize your answer sheet as follows:

Inappropriate Action	What Brown Should Have Done to Avoid Inappropriate Action

AICPA

professional simulation

Situation	Various Assurance Engagements	Research

Jennifer Robben is a partner in the CPA firm of Robben, Harrison and Co. During the course of a year she receives a number of requests from clients for various services. The following questions address the firm's ability to provide these services in accordance with professional standards.

Situation	Various Assurance Engagements	Research

Following is list of various engagements that a client might ask a CPA to perform. Identify the professional standards that provide guidance on performing the engagement.

a. Statements on Auditing Standards

b. Statements on Standards for Attestation Engagements

c. Statements on Standards for Accounting and Review Services

d. The engagement is not appropriate under current professional standards

	a.	b.	c.	d.
1. A private company client would like to have your accounting firm provide reasonable assurance that a financial forecast of the next year's financial position, results of operations, and cash flows will be achieved.	○	○	○	○
2. A private company needs to provide a bank with financial statements. It does not want to pay for an audit, and the bank is willing to accept less than audited financial statements. Can your firm provide negative assurance that your firm is not aware of any material modifications that need to be made to the financial statements in order for them to be in accordance with GAAP?	○	○	○	○
3. A public company would like you to perform agreed-upon procedures regarding a royalty payable where the client owes royalties based on the number of parts produced under a licensing agreement.	○	○	○	○

4. A private company would like to have you audit financial statements prepared on a federal income tax basis of accounting. ○ ○ ○ ○

5. A public company would like to have you provide a report to lenders providing them with some level of assurance that the company complied with terms, covenants, and provisions of a debt agreement. ○ ○ ○ ○

6. A local casino would like to provide a report to the public that provides reasonable assurance that that payout rate on its slot machines was greater than or equal to 97 percent. ○ ○ ○ ○

7. A private company client would like to you compile a financial projection, with no assurance, that would project financial position, results of operations and cash flows based on assumptions agreed upon by the client and the bank. ○ ○ ○ ○

8. A public company in the petroleum industry would like to have your firm conduct an agreed-upon procedures engagement to the Environmental Protection Agency (EPA) that it complied with the EPA regulation that its gasoline product contained at least 2 percent oxygen. ○ ○ ○ ○

Situation	Various Assurance Engagements	Research

Following is list of engagements that were requested of Jennifer Robben during the last year. In the space provided in the table below indicate the appropriate professional standard paragraph(s) that provide example reports relevant to each engagement.

	Professional Standard Reference
1. A private company client would like to have your accounting firm provide reasonable assurance that a financial forecast of the next year's financial position, results of operations, and cash flows will be achieved.	________
2. A private company needs to provide a bank with financial statements. It does not want to pay for an audit, and the bank is willing to accept less than audited financial statements. Can your firm provide negative assurance that your firm is not aware of any material modifications that need to be made to the financial statements in order for them to be in accordance with GAAP?	________
3. A public company would like you to perform agreed-upon procedures regarding a royalty payable where the client owes royalties based on the number of parts produced under a licensing agreement.	________
4. A private company would like to have you audit financial statements prepared on a federal income tax basis of accounting.	________
5. A public company would like to have you provide a report to lenders providing them with some level of assurance that the company complied with terms, covenants, and provisions of a debt agreement.	________

6. A local casino would like to provide a report to the public that provides reasonable assurance that that payout rate on its slot machines was greater than or equal to 97 percent. ________

7. A private company client would like to you compile a financial projection, with no assurance, that would project financial position, results of operations and cash flows based on assumptions agreed upon by the client and the bank. ________

8. A public company in the petroleum industry would like to have your firm conduct an agreed-upon procedures engagement to the Environmental Protection Agency (EPA) that it complied with the EPA regulation that its gasoline product contained at least 2 percent oxygen. ________