SSARS Nos. 16 And 17 Teleconference

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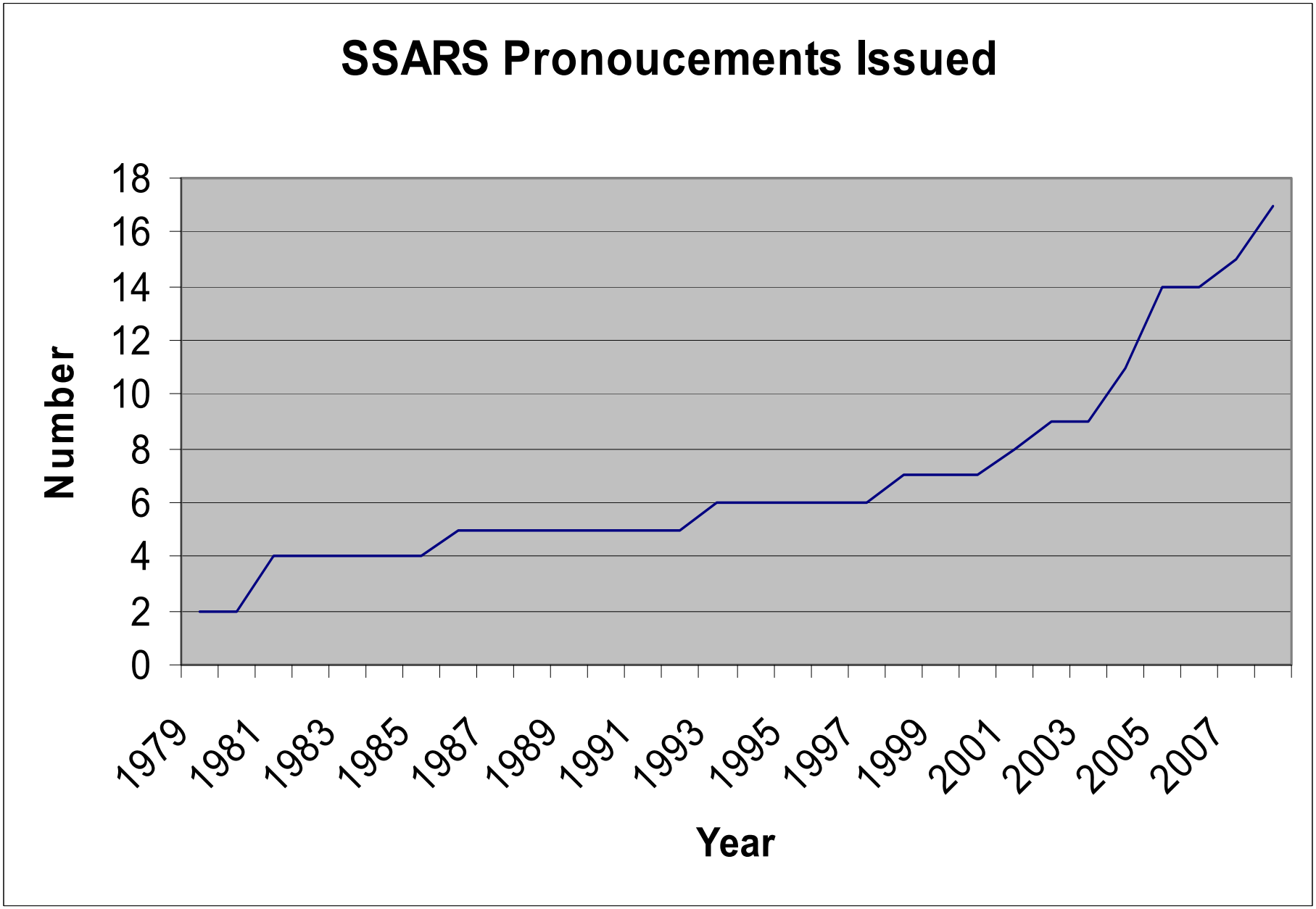
Today's Program

- Recent History Of Compilation And Review Guidance (slides 3-7)
- SSARS No. 16 Review (slides 8-14)
- SSARS No. 17 Review (slides 15-35)
- Reliability And Clarity Issues (slides 36-40)

Recent History Of Compilation And Review Guidance

Recent History In Compilations And Reviews

- 1979: SSARS begins
- 1999: We are up to SSARS 7
- 2008: SSARS 17 is issued


SSARS Pronoucements Issued
Number
18
16
14
12
10
8
6
4
2
0
1979
1981
1983
1985
1987
1989
1991
1993
1995
1997
1999
2001
2003
2005
2007
Year

Recent History In Compilations And Reviews

- 1992: SAS 69 issued – GAAP hierarchy
- 2002: Sarbanes-Oxley becomes law
- 2007: SSARS 15 issued

History - SSARS 15

- Provides guidance on appropriate financial statement titles, including OCBOA
  - Note: OCBOA titles have been a common peer review finding

- Eliminates the reference to ‘SAS’
  - SSARS guidance must now stand on its own
  - The result that SSARS no longer addresses discovery of reporting issues
  - Leading to the issuance of standards such SSARS 16 and 17

SSARS No. 16 Review

Clarity

- Adding structure and clear language to review and compilation engagements

- Multiple projects necessary to accomplish goals and objectives:
  - Clearer language
  - New format to standards

- SSARS 15, “Defining Professional Requirements in Statements on Standards for Accounting and Review Services”
  - First step in providing “clearer language”

“Must” Or “Is Required”

- Unconditional requirement
  - The accountant is required to comply with an unconditional requirement in all cases in which the circumstances exist to which the unconditional requirement applies

“Should”

- Presumptively mandatory requirement
  - The accountant is also required to comply with a presumptively mandatory requirement in all cases in which the circumstances exist to which the presumptively mandatory requirement applies. However, in rare circumstances, the accountant may depart from a presumptively mandatory requirement, provided that he or she documents justification for the departure and how the alternative procedures performed in the circumstances were sufficient to achieve the objectives of the presumptively mandatory requirement
- “Should consider”
  - The consideration is the presumptive requirement

Documentation Requirements

- Documentation in a review engagement (AR 100.43 through .45)
  - The accountant should prepare documentation in connection with a review of financial statements, the form and content of which should be designed to meet the circumstances of the particular engagement
  - Inquiries and analytical procedures should be documented
  - Representation letter should be retained in working papers
- Compilations do not have specific documentation requirements, with the exception of an engagement letter on "management use only" engagements
- Ethics ruling ET 101-3 requires documentation of non-attest services performed by the accountant
- Under SSARS 16, documentation is required for both reviews and compilations when a mandatory presumptive requirement is not performed

Potential Misinterpretations

- Documentation requirement is not intended to change practice

- Certain paragraphs in the standards may be interpreted to require documentation on compilation engagements
  - Currently, there are seven uses of the term “must” in Sect. AR 100
  - Currently, there are 196 uses of the term “should” in Sect. AR 100

- Current uses of unclear language
  - “Ordinarily should”
  - “Usually should”
  - “Should be avoided”

The Next Step

- Need to re-write and re-format the existing standards to provide clearer language and format standards, by separating requirements from application guidance

SSARS No. 17 Review

SSARS No. 17 Review

- The standard makes references to GAAP, however it applies to OCBOA statements

- The standards eliminate the references to public and non-public companies and replaces them with:

SSARS No. 17 Review

Issuer. ***An issuer is defined in section 3 of the Securities Exchange Act of 1934 [15 U.S.C. 78c], the securities of which are registered under section 12 of that Act (15 U.S. C. 78l), or that is required to file reports under section 15(d) (15 U.S.C. 78o(d)), or that files or has filed a registration statement that has not yet become effective under the securities act of 1933 (15 U.S.C. 77a et esq.), and that it has not withdrawn***

Non-issuer. ***All entities except for those defined as issuers***

Note: SSARS standards still apply only to non-issuers (non-public). Although issuers have interim reviews performed, they are not performed under the SSARS guidance

SSARS No. 17 Review

- **Compilation of financial statements.** *A service, the objective of which is to present in the form of financial statements, information that is the representation of management (owners) without undertaking to express any assurance on the financial statements*

SSARS No. 17 Review

- **Limitations of a compilation engagement**

  A compilation differs significantly from a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Therefore, a compilation does not provide a basis for expressing any level of assurance on the financial statements being compiled

SSARS No. 17 Review

- **Review of financial statements.** *A service, the objective of which is to express 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*

SSARS No. 17 Review

Review performance requirements .

In order to obtain a reasonable basis for the expression of limited assurance, the accountant must.

- **Apply analytical procedures to the financial statements .**
- **Make inquiries of management and, when deemed appropriate, other company personnel .**
- **Obtain representations from management for all financial statements and periods covered by the accountant's review report.**

SSARS No. 17 Review

Limitations of a review engagement

A review differs significantly from an audit of financial statements in which the auditor provides reasonable assurance that the financial statements, taken as a whole, are free of material misstatement. A review does not contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; tests of accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation or the examination of source documents (for example, cancelled checks or bank images) ***Continued on next slide***

SSARS No. 17 Review

Limitations of a review engagement (Cont.)

... or other procedures ordinarily performed in an audit. Accordingly, a review does not provide assurance that the accountant will become aware of all significant matters that would be disclosed in an audit. Therefore, a review provides only 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

SSARS No. 17 Review

- One of the results of redefining compilation and review terms is changes in standard engagement letters

Note: Examples of revised engagement letters are provided in background materials for this teleconference

SSARS No. 17 Review

- **Redefines the following:**

  Those charged with governance. *The person(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability for the entity. This includes overseeing the financial reporting process. In some cases, those charged with governance are responsible for approving the entity's financial statements (in other cases, management has the responsibility). In some entities, governance is a collective responsibility that may be carried out by a board of directors, a committee of the board of directors, a committee of management, partners, equivalent persons, or some combination thereof. Those charged with governance are specifically excluded from management, unless they perform management functions as defined below* ***Continued on next slide***

SSARS No. 17 Review

- **Management.** *The person(s) responsible for achieving the objectives of the entity and who have the authority to establish policies and make decisions by which those objectives are to be pursued. Management is responsible for the financial statements, including designing, implementing, and maintaining effective internal control over financial reporting*

- **Third party.** *All persons, including those charged with governance, except for those members of management as defined above*

Management Representation Letters

- Required for review engagements
- Covers all periods covered by the accountant's review report
- Management accepts responsibility for the financial statements
- Covers events through the date of the review report

- Report date should be as of the completion date, which does not occur until management provides representation

- Therefore, the management representation letter should be dated as of the date of the review report at the conclusion of the engagement

The accountant need not be in physical receipt of the management representation letter as of the date of the accountant's review report, provided that management has acknowledged that they will sign the representation letter without modification and it is received prior to the date the report is released

Management Representation Letters

- Management representation letters must be tailored to the client

- Many examples are included in SSARS 17
  - Debt securities that have been classified as held-to-maturity have been so classified due to the company's intent to hold such securities to maturity and the company's ability to do so. All other debt securities have been classified as available-for-sale or -trading
  - Provisions have been made to reduce excess or obsolete inventories to their estimated net realizable value
  - Note [*X*] to the financial statements discloses all of the matters of which we are aware that are relevant to the company's ability to continue as a going concern, including significant conditions and events, and management's plans

Going Concern Evaluation

- Required on both review and compilation engagements
- The accountant may become aware of information that there may be an uncertainty as to the company's ability to continue as a going concern for a reasonable time
- Reasonable time is not to exceed one year
- Consider management's conclusions and the adequacy of disclosures

Going Concern Evaluation

- Examples of information that may lead to a going concern evaluation:
  - Recurring losses
  - Negative equity
  - Line of credit has expired without a renewal in effect
  - Long-term union strike
  - Loss of primary customer or supplier
  - Customer bad debt/bankruptcies
  - Unexpected loss of an owner/key employee
  - Cash flow shortages

Subsequent Events

- Transactions may occur subsequent to the balance sheet date but prior to the **release** date, which may have a material impact on the financial statements and require disclosure

- These items may come to the accountant's attention:
  - *During the performance of compilation or review procedures*
  - *Subsequent to the date of the accountant's compilation or review report but prior to the release of the report*

Subsequent Events

- Examples
  - Fire or other natural catastrophe
  - Labor strike
  - Merger or acquisition
  - Capital expenditure commitment
  - Material bad debt or bankruptcy

Analytical Procedures

- SSARS 17 incorporates additional guidance relative to the requirement of establishing expectations for analytical procedures prior to performing a review engagement set forth in SSARS 12 amendment to AR Sect. 100

- Forming an expectation is an integral phase of the analytical procedure process

- Expectations are the accountant's predictions of recorded amounts or ratios developed from recorded amounts
  - Historical data, preliminary data, budgets, forecasts
  - Industry data
  - Interview client management
  - Other

Expectations – Sample

- Upon interviewing client management, the accountant learns that the company has expanded operations to include three new products, hired 25 new employees including two engineers and one IT specialist, as well as potential collectability issues for a specific customer that could result in bad debt. Accountant also reviews interim financial statement and compares to prior two years

- Expectations may include:
  - AR expected to be up 15% due to similar increase in sales, while maintaining a steady profit margin on all product lines
  - Inventory volume expected to be up 10% due to product expansion
  - Expenses expected to increase in proportion to increase in sales with the exception of engineering and IT wages, which were new line items, and bad debt expense for the specific reserve of one account

Expectations - Results

- The analytics procedures and inquiry performed during the review must be compared to the expectations set forth previously
- The accountant should obtain explanations for any significant variances
  - In the previous example, the accountant did not find that a significant bad debt was recorded. Upon further inquiry, the accountant discovered that the balance was paid in full subsequent to year-end but prior to the review

Reliability And Clarity Issues

Reliability Project

- A question exists regarding whether a new service is necessary to provide a level of assurance on engagements, in which independence is impaired due to performing non-attest services that are necessary to improve the “reliability” of the financial statements

- Are integrity and objectivity sufficient when independence is lost due to performing non-attest services?

Assurance Continuum

Aspects Of Independence

- SSARSes currently permit a CPA to perform a compilation, but not a review, when the CPA's independence has been impaired. If an accountant performs a compilation for a client to which he or she is not independent, the accountant should disclose the lack of independence in his or her accountant's report. The accountant is precluded from disclosing the reason for the impairment of independence in the report
- CPAs may perform non-attest services such as "control activities" that impair independence
- CPAs may also perform non-attest services in which the client must have "suitable skills" to oversee those services, in order to maintain independence

Possible Outcomes

- Review level of service when the scope of service independence is impaired
- Compilation engagements may allow the description of independence (scope of service vs. relationship/financial interests)