

Via email

August 24, 2012

Mike Glynn, Accounting and Review Services Committee
American Institute of Certified Public Accountants
New York, NY

Re: Comments on Proposed Changes to the Proposed Standards for Accounting and Review Services

To the Committee Members:

As I write this, I consider that disagreeing with a proposed standard is like standing in front of a slowly moving locomotive; eventually it will run you over, or you will decide to step aside and hop on the train if you want to continue in the profession. Perhaps my reaction is the result of the natural angst we can feel when confronted with uncomfortable change. Nevertheless, here is my feedback to the Committee as they continue their important work.

Proposed Statement on Standards for Accounting and Review Services – Association with Unaudited Financial Statements

Comment on explanatory material A4:

I am most concerned with the ability of a member to provide a new level of “report”. Under the proposed standard, a member can theoretically offer four levels of reporting service on financial statements intended for third-party use: disclaimer¹, compilation, review, or audit.

Certainly encouraging the client to add a disclaimer to its statements indicating that the statements were neither compiled, reviewed, nor audited can be beneficial to all parties in communicating the level of outside assurance on the information. Such disclaimers are well advised when the member is providing bookkeeping, controllership, or other consulting services—for example, valuation engagements where financial statements or schedules may be included in the report. Disclaimers are also advisable whenever the CPA becomes involved in client communications that may include assertions about financial or other matters.

Unfortunately, the proposed standard seems to offer a new level of service, based on mere association with a CPA (presumably trading on the member’s reputation), as a reasonable reporting approach. In short, I believe a member should not be allowed to provide a one sentence disclaimer-type report when financial statements are provided to a third party in association with that member.

I am also not certain if the committee has considered whether such 'one sentence reports' should require an independence assessment and reporting similar to that required for a compilation. As it stands, the requirement would not exist since the engagement would fall outside the scope of attest services. Would the failure to notify a third-party of potential objectivity impairment during a member's mere association with the statements be an issue?

Comment on Requirements, Association with Unaudited Financial Statements:

6. If an accountant is requested to be associated with unaudited financial statements for the reasons described in paragraph 5a, the accountant should
 - a. read the unaudited financial statements.
 - b. consider whether the unaudited financial statements appear free from material inconsistencies with other knowledge or information of which the accountant may be aware.

The proposed standard requires the member to 1) read the statements and 2) consider whether the statements are free of material misstatement. Absent proper form considerations², these are the same performance requirements contained in the newly proposed compilation standard. Having performed the first two steps, the remaining requirement is to report. Providing a disclaimer report³ instead of a compilation report would seem to be of little distinction.

Certainly a disclaimer report would not meet the compilation standard, so it would be appropriate to state that the member did not compile, review, or audit. But this approach begs the question. By preparing a correct type of report and assuming proper form considerations that are likely required in an assessment of material misstatement, the member would meet the compilation standard. Why make a lesser reporting route an option? The problem then may be with the new compilation definition.

This proposed standard brings to mind the debate surrounding financial statement assembly engagements a few years back and the contention by certain groups that compilations are not, in fact, *attest* engagements. There is a wonderful article in the May 1999 issue of the Journal of Accountancy on this very subject (<http://www.journalofaccountancy.com/Issues/1999/May/special.htm>).

Comment on A5 - situations when the accountant's name has been used without the accountant's permission, actions that the accountant may consider include....

I ask the committee to consider adding an additional item d, perhaps reading somewhat as follows: If circumstances permit, such as when the association was inadvertent or without apparent improper intent, then the member may, after proper consideration, offer to provide the appropriate level of service on the financial statements.

Consider a scenario when a member has assisted in the preparation of management-use-only statements or performed bookkeeping or controllership services. The member later learns that the

client has presented internally prepared statements to a banker or other third party and mentioned the CPA's name as a reference. It may be unclear as to whether the client presented the CPA prepared management-use-only statements in contravention of the practitioner's written agreement or the extent of any assurances provided by the client to the outside party. The CPA can, after careful investigation and deliberation, consider the potential of providing a step-up in services to meet third-party reporting needs. In some situations the proper path may be one of service opportunity, not conflict.

Proposed Statement on Standards for Accounting and Review Services *Compilation of Financial Statements*

The dictionary defines compiling or to compile as "the act of gathering things together or compose out of materials from other documents"⁴ or "to produce (something, especially a list, report, or book) by assembling information collected from other sources"⁵. My definition of compilation for our profession is the act of gathering, summarizing, and formatting and presenting information. Some examples include compiling a schedule of accounts receivable, a fixed asset listing, a statement of receipts and disbursements, or a full set of financial statements. A *compilation engagement* goes beyond the mere preparation and reporting on the financial statements, and the current performance standards serve the profession and the public well.

There is little confusion about the nature of a compilation engagement and our reporting requirements except when it comes to the word 'attest'. Fortunately, we are provided with the relevant distinction: a compilation is an *attest* engagement, but it is not an *assurance* engagement. Compilations, reviews, and audits all exist within the attest realm, but only reviews and audits provide any assurance.

I believe the failure to make the proper distinction and understand the interrelation between attest and assurance causes some to conclude that compilation procedures are more correctly classified as a nonattest service. Further practitioner confusion is driven by our failure to fully understand our independence requirements, with much of this misunderstanding driven by the original release of Interpretation 101-3 and, now, the new Yellow Book guidance.

The proposed standard seeks to limit compilation procedures to reading and reporting. This revised definition belies the very nature of the services we provide to our clients. In all my years of experience, I have never simply read and considered then reported during a compilation engagement. As one of my colleagues puts it, "How does this new definition even make sense?" To say that I have performed both an attest and a nonattest service during a compilation engagement is to draw a distinction that is somewhat overwrought. We rarely, if ever, encounter read and report engagements in practice – there is no such market demand, and such newly defined compilation engagements simply would not exist on their own.

The revised definition introduces a delineation and abstraction of concepts more academic than practical. Such a distinction does not serve the public. However, it will serve to fuel the arguments of those who believe that assisting in the preparation of financial statements is a threat, perhaps insurmountable, to our independence. Since, under the proposed definition, nearly if not all, real-world compilations would involve both attest and nonattest components, many practitioners will simply

capitulate to the idea that their objectivity is somehow impaired. I see this trend today, and it troubles me. Our independent and objective approach as well as our education, training and experience are the very reasons our services are in demand. The vast majority of small businesses and nonprofits rely on our expertise to assist in the preparation of their financial reporting packages. Third parties fully understand our role and overwhelmingly support the position that preparing financial statements does not, in and of itself⁶, impair our independence.

One supporting argument for such a change in definition is to harmonize the compilation standards, simultaneous with the change in ethical interpretations, with the framework for independence provided by the Government Accountability Office (in the new 2011 Yellow Book edition). Certainly a principles-based threats and safeguards approach to independence provides a better framework than a rules-based approach, but I don't believe the GAO intended to force this change in the attest standards.

The 2011 revision of the Yellow Book contains a consistent understanding of both attest services and professional standards. The independence definition substitutes the term objective for the word reasonable when defining the *independence in appearance* requirement, but is otherwise in accordance with the ethical standards of the AICPA. The authors of the revised government auditing standards undertook the stated effort to harmonize those standards with other current professional standards, which makes sense given the Yellow Book was last revised in 2007. It would appear they believed they achieved their goal, and no such disharmony exists.

A potential problem arises when the Yellow Book offers examples of *nonaudit* services that may impair independence. Particularly problematic for some practitioners is section 3.40, which lists financial statement preparation, cash to accrual conversions, and reconciliations as nonaudit activities and not routine activities.⁷ Given the authors' understanding of attest and independence, the GAO's choice of the term *nonaudit* is interesting and perhaps telling. I don't believe the GAO intended to introduce the idea that independence standards may be different for audit services versus other attest services. On the other hand, perhaps they provided the AICPA with a gracious out and selected the term nonaudit as a means to allow the Institute time adopt a definition of attestation and ethical standards modifications more in line with the GAO's thinking.

The idea may be somewhat naive, but perhaps the GAO's choice of the term nonaudit versus nonattest was precisely to avoid any such conflict. Since practitioners cannot perform more than one level of service on the financial statements, the GAO may have been broaching the subject that preparing financial statements, cash to accrual conversions, account reconciliation and so forth, many of the procedures undertaken during a compilation, are a potential problem when performing audit services. Their careful choice of the term nonaudit was to avoid conflict, not to produce further change.

Perhaps if we just remove compilations from the attest realm, the entire issue goes away. Maybe it is time for an assurance realm and a separate a nonattest or nonassurance realm – simplified clarity. We could then have two levels of nonattest/nonassurance reporting engagements: assembly and compilation. I would not welcome such an approach, but delineating assurance and nonassurance may be the sought after solution. The 2015 Yellow Book revision can then use nonattest or nonassurance in place of nonaudit.

Comment on language in the new report *A44. Exhibit—Illustration of Accountant’s Compilation Reports on Financial Statements*:

I have added my suggested edits to the report as follows:

Our responsibility is to report on the financial statements based on our compilation. We compiled the financial statements in accordance with Statements on Standards for Accounting and Review Services [SSARs] promulgated by the Accounting and Review Services Committee of the American Institute of Certified Public Accountants. The objective of a compilation engagement is to read the financial statements and consider whether the financial statements ~~are~~ appear^a free from obvious material misstatements and whether they ~~appear to be~~ are^b appropriate in form, without undertaking to obtain or provide any assurance that there are no material modifications necessary in order for the statements to be in conformity with accounting principles generally accepted in the United States of America, and to report in accordance with the requirements of the SSARs.

^a I disagree with use of the word ‘are’ in characterizing our consideration of material misstatement. A better word would be ‘appear’, as in the sense of seemingly, or perhaps seem. The term ‘are’ introduces a degree of certainty and aura of assurance that is not present in the services we performed. By reading and considering the statements, we may conclude that they appear to be, or are *seemingly* correct. To suggest that they ‘are’ correct is problematic, both from a factual and legal liability point of view. Since we have undertaken no procedures to determine if the statements in fact are correct, we should not say they ‘are’.

^b Here the word ‘appear’ may lead to some confusion. I believe the intended meaning is one based on appearing, in the visual sense, and not seemingly as I used above. I would be more comfortable with using ‘are presented in appropriate form’ or simply ‘are appropriate in form’ in this instance. As CPAs, we should be able to provide this degree of certainty on format and presentation, since, in most every case, we will have done the work.

If we report otherwise, I am not sure that we have achieved our objective “to prevent misinterpretation regarding the degree of responsibility the accountant assumes....” If we need to revise the proposed performance standards to mirror the proposed language above, we should.

Objectives

3. The accountant’s objectives in a compilation engagement are to
 - a. read the financial statements and consider whether the financial statements ~~are~~ appear to be free from obvious material misstatements and whether they ~~appear to be~~ are appropriate in form, without undertaking to obtain or provide any assurance that there are no material modifications necessary in order for the statements to be in conformity with the applicable financial reporting framework and (Ref: par. A3)

¹ Perhaps short disclaimer or nonattest report or even accountant's disclaimer letter, would be a better term. Reports would exist only for attest services; letters for nonattest services.

² Form considerations may be difficult to separate from material misstatement considerations; hence, I believe the performance standard offered here is substantially equivalent to the proposed compilation standard – if the form is materially incorrect, the statements are materially incorrect.

³ I would not call such disclaimers a 'report' – see my suggestion in footnote 1 above.

⁴ Merriam-Webster online dictionary – English language learners and dictionary definition.

⁵ Oxford Dictionaries online.

⁶ This assumes full compliance with the revised threats and safeguards framework, both in deed and spirit – in accordance with both AICPA and GAO standards.

⁷ Unfortunately, many practitioners simply assume impairment is automatic, unwilling to fully consider the guidance at 3.46, which would allow auditors to perform such services as long as they complied with the requirements set forth in the guide. Often practitioners trip over the requirement for a member of management with suitable skill, knowledge and experience to oversee the work. Many simply say that no such member of management exists...how they then determine management is able to accept responsibility for the statements, which is required, I don't know.

I want to thank the Committee for their hard work and for taking the time to consider my comments.

Sincerely,

Randall L. Brookshier,
Certified Public Accountant