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100 Why All the Commotion?

100.1 The AICPA rules relating to future-oriented financial information are complex and comprehensive. The rules affect tax planning, budgeting, modeling, forecast, and projection engagements. In addition, firms that are members of the AICPA and in public practice should consider those rules when designing their quality control systems. (See section 203.) It is important that all practitioners who are involved with future-oriented financial information fully understand the rules so that services on prospective financial statements can be delivered correctly and in a cost-effective manner.

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101 Why Were the Rules Developed?

101.1 The AICPA was motivated to develop guidance for financial forecasts and projections by two major factors: (a) concern about the growing diversity in practice and (b) requests from practitioners. Accordingly, the AICPA Auditing Standards Board (ASB) issued a Statement on Standards for Practitioners' Services on Prospective Financial Information titled *Financial Forecasts and Projections*.[1] Although the AICPA Statement was not the first document to set rules in that area of practice, it became the framework for all practitioners' services on prospective financial information because it established enforceable standards for a large portion of practice in that area.

Diversity in Practice

101.2 Practitioners have provided services on prospective financial information for many years. They traditionally have helped their clients plan operations, obtain financing for expansion, and minimize future years' taxes, and have lent assistance in other areas related to planning and accounting for future events. To effectively render those services, practitioners often helped their clients develop future-oriented, or prospective, financial information.

101.3 Practitioners in all disciplines of the profession provide services on prospective financial information. Tax practitioners often refer to the services as tax planning; Management Consulting Services (MCS) practitioners refer to them as advisory services; and auditors often call them compilation or audit of prospective information. The resulting prospective information may be in any number of forms such as budgets, acquisition studies, and data to be used in contract negotiations.

101.4 As the cost of developing and analyzing data has fallen, practitioners have discovered an expanding market: cost-effective services on prospective financial information for clients of all sizes.

101.5 Investors, realizing that historical financial statements do not fulfill all of their information needs, also have contributed to an increased demand for services on prospective financial information. They want information about what is likely to happen in the future in addition to information about what has happened in the past. Investors realize that no one can predict the future with certainty, but they believe that access to prospective financial information helps them make better decisions. Thus, the

objective of developing prospective financial information is not to predict the future, but to provide information to improve the decision-making process. As a result, prospective financial information is now commonly included in certain types of investment offerings.

101.6 The combination of an expanding marketplace and the lack of professional standards governing practice resulted in a diversity in the services practitioners rendered. The AICPA Auditing Standards Board was concerned that prospective financial statement users would be confused when confronted with a diversity of practitioners' services and reports.

Requests from Practitioners

101.7 As practice expanded into the area of forecasts and projections, practitioners became concerned about the appropriateness of the nature and extent of their procedures and the types and forms of their reports. The AICPA received numerous requests, predominantly from local practitioners, for guidance on practitioners' services on prospective information.

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[1] In January 1989, *Financial Forecasts and Projections* was codified in the AICPA's *Codification of Statements on Standards for Attestation Engagements* as part of Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards*. In February 2001, SSAE No. 1 was superseded by SSAE No. 10. See paragraph 102.3 for additional discussion of SSAE No. 10.

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102 How Do the Rules Affect My Practice?

102.1 Faced with the tremendous pressures of public accounting, most practitioners would like a quick understanding of what effect, if any, the literature has on a typical engagement. Said another way, there is a natural temptation to think, “I already know how to cook, just give me the recipe for my engagement.” However, the AICPA rules are very complex, and there is no quick way to master the literature. The time required to understand how the literature affects a particular engagement probably parallels the time practitioners spent in mastering the Statements on Standards for Accounting and Review Services (SSARS) when they were first issued. [2]

102.2 To avoid getting immediately bogged down in the detailed requirements of the rules, the authors have prepared the following overview that summarizes the literature and cross-references the different aspects of the literature to discussions in this guide. In addition, Appendix 1A contains a “quick start” to understanding the rules on prospectives. It is designed to familiarize practitioners with the services allowed under existing standards and with the presentation guidelines that govern the form and content of forecasts and projections.

What Are the Rules?

102.3 The basic rules were originally set forth in Statement on Standards for Practitioners' Services on Prospective Financial Information titled *Financial Forecasts and Projections* (the AICPA Statement or the Statement). As previously discussed, that Statement was codified in January 1989 in Section 200 (AT 200) of the AICPA's *Codification of Statements on Standards for Attestation Engagements* and became known as Statement on Standards for Attestation Engagements (SSAE) No. 1, *Attestation Standards*. However, SSAE No. 1 was superseded by SSAE No. 10. In fact, SSAE No. 10 also superseded SSAE Nos. 2 through 9. Thus, when SSAE No. 10 was issued, [3] it revised and recodified the guidance for attestation engagements, including for example, guidance for historical financial information (AT 101), guidance on performing procedures and reporting on examinations or reviews of pro forma presentations (AT 401), and guidance on forecasts and projections (AT 301), which is the primary focus of this book. Consequently, to distinguish the guidance on forecasts and projections from the other guidance contained in SSAE No. 10, the

authors will refer to AT 301 throughout this guide when discussing such guidance. Practitioners performing engagements on prospective financial information should also comply with the guidance in SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements*, as discussed beginning at paragraph 106.11, and SSAE No. 14, *SSAE Hierarchy*, as discussed beginning at paragraph 106.14. [4]

102.4 The AICPA *Guide: Prospective Financial Information* (the AICPA *Guide*) was first issued in February 1993 and superseded the original AICPA *Guide for Prospective Financial Statements* issued in 1986 as a companion publication to the AICPA Statement. The AICPA *Guide* was issued to incorporate the guidance contained in the original guide, the AICPA Statement, and the following Statements of Position (which the AICPA subsequently withdrew): No other substantive changes were made.

• SOP 89-3, *Questions Concerning Practitioners' Services on Prospective Financial Statements*.

• SOP 90-1, *Accountants' Services on Prospective Financial Statements for Internal Use Only and Partial Presentations*.

• SOP 92-2, *Questions and Answers on the Term "Reasonably Objective Basis" and Other Issues Affecting Prospective Financial Statements*.

102.5 The AICPA *Guide* has been revised many times:

• April 1997—Revised to incorporate the guidance contained in SSAE No. 4, *Agreed-Upon Procedures Engagements*, and to present certain provisions of the Private Securities Litigation Reform Act of 1995. In 2002, the AICPA revised the AICPA *Guide* to incorporate the guidance in SSAE No. 10 and SSAE No. 11.

• June 1998—Revised the AICPA *Guide* to include a copy of SOP 98-5, *Reporting on the Costs of Start-Up Activities*.

• May 1999—Revised to incorporate Statement of Financial Accounting Standards (SFAS) No. 128, *Earnings per Share*, SOP 98-5, SSAE No. 7, *Establishing an Understanding With the Client*, and SSAE No. 8, *Management's Discussion and Analysis*.

• May 2003—Revised to incorporate the guidance in SSAE No. 12.

• May 2005—Revised to reflect the standards of the PCAOB, the issuance of amended U.S. Treasury Circular 230, and to clarify certain guidance.

• May 2006—Revised to refer to, among other things, a discussion of the requirements of SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements*, the guidance in SFAS No. 154, *Accounting Changes and Error Corrections*, SAS No. 107, *Audit Risk and Materiality in Conducting an Audit* and SAS No. 108, *Planning and Supervision*. Also, Appendix C was updated to reflect the issuance of amended U.S. Treasury Circular 230.

• May 2007—Updated Chapter 13, *Illustrative Engagement and Representation Letters for a Compilation*, updated certain appendixes, and revised, added, or deleted various footnotes.

• March 2008—Updated to conform with SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements* and SSAE No. 14, *SSAE Hierarchy*, and updated Appendix B, *SEC Safe Harbor Rule for Projections*, and Appendix C, *IRS regulations Regarding Tax Shelter Opinions (Circular 230)*.

• March 2009—Added FASB Accounting Standards Codification (FASB ASC) references and clarified various paragraphs throughout for conforming changes made in the March 2008 guide for SSAE No. 13.

• November 2012—Updated to reflect conforming changes for issuance of the clarified auditing standards (SAS Nos. 122-126), as applicable, and issuance of SSAE No. 17, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired*.

102.6 Throughout this book, references are to paragraph numbers in the 2012 updated AICPA *Guide*. Also, the authors refer to *this* book as the guide, not capitalized and without italics, to distinguish it from the AICPA *Guide*.

What Are the Various Engagements?

102.7 There are two broad categories of prospective financial statement engagements—internal use and third-party use. Within those broad categories, practitioners can provide five levels of service. The types of services are as follows:

- *Internal Use*

  - Assembly (with or without a report).

- *Third-party Use*

  - Special disclaimer on current-year budgets presented with interim historical financial statements.

  - Compilation (not a SSARS compilation).

  - Agreed-upon procedures.

  - Examination.

102.8 **Assembly**

Practitioners may render compilation, agreed-upon procedures, or examination services in internal use engagements; however, the procedures performed and the presentation, disclosure, and reporting requirements are the same as those required for third-party engagements. Therefore, the most common level of service on prospective financial statements for internal use is an assembly. In such an engagement, the practitioners do not provide any type of assurance. They merely perform mathematical calculations to convert assumptions into prospective amounts or other clerical functions related to the presentation of the prospective financial information. As discussed more fully in Chapter 4, practitioners may perform assembly services and either issue or not issue a report. The professional requirements vary, however, depending on the form of practitioners' communication. The following are the general types of reporting situations on assembly services:

a. *Plain Paper.* In a plain paper engagement, the practitioners' names are not to be “associated” with the presentation. In the authors' opinion, the presentation may not—

(1) be accompanied by an practitioners' report or transmittal letter;

(2) be printed on the practitioners' letterhead or with the practitioners' logo;

(3) be presented in the practitioners' report cover;

(4) refer to the practitioners in the presentation; or

(5) be bound with or shown alongside historical financial statements that the practitioners have compiled, reviewed, or audited.

As discussed in section 403, the authors believe that if any of the preceding conditions exists, the practitioners are associated with the prospective presentation and should prepare the appropriate communication discussed in item b. or c.

b. *Written Communication.* Although the AICPA *Guide* does not define the term *written communication*, the authors believe that such a communication is a written document that indicates both the name of the accounting firm and the prospective financial statements involved (for example, a transmittal letter). The practitioners' procedures, conclusions, analyses, or recommendations with respect to the prospective financial statements are not included in the communication. If the prospective statements are accompanied by the practitioners' written communication, the statements or the communication should contain the following:

(1) A caveat that the prospective financial results may not be achieved.

(2) A statement that the prospective financial statements are for internal use only.

Transmittal letters and other written communications are discussed more fully in section 404.

c. *Assembly Report.* When practitioners want to describe their service or discuss the statements in writing, they issue a report. The form of the report is flexible because there are very few requirements. The AICPA *Guide* contains several recommendations, however, for the content of the report. Those recommendations are discussed in detail in section 405.

102.9 **Special Disclaimer on Budgets**

When prospective financial statements are intended for third parties, practitioners should either compile, apply agreed-upon procedures, or examine the statements. As is discussed in greater detail in section 803, such guidance does not apply to practitioners' services on certain presentations intended for third-party use, however. If prospective presentations (a) are labeled “budgets” and do not extend beyond the current year end and (b) are presented with interim historical financial statements, practitioners are not required to apply any procedures. However, practitioners should issue a report that—

a. states that they did not examine or compile the budget, and

b. disclaims an opinion or any other form of assurance on the budget.

102.10 **Compilation**

Compilation engagements (not to be confused with compilations performed in accordance with the SSARS) are generally recognized as the lowest level attest service that practitioners can provide on prospective financial statements intended for third-party use. A compilation engagement involves: (a) assembling the prospective financial statements to the extent necessary, (b) reading the prospective financial statements for conformity with AICPA presentation guidelines and for consideration of whether they appear to be obviously not inappropriate, and (c) issuing a compilation report. A compilation report disclaims an opinion or any assurance on the prospective financial statements and their assumptions. Chapter 5 discusses compilation engagements.

102.11 **Agreed-upon Procedures**

Agreed-upon procedures engagements involve: (a) applying procedures to prospective financial statements that have been agreed-upon by the specified parties, and (b) issuing a report that enumerates the procedures performed, states the practitioners' findings, and restricts the use of the report to the specified parties that agreed to the procedures. Such engagements can be very limited or quite extensive. For example, practitioners could agree to assemble the statements, read them for

compliance with AICPA presentation guidelines, and test them for mathematical accuracy; or they could agree to perform a demand analysis to support forecasted sales or other procedures more common to an examination. The AICPA *Guide* provides, however, that merely reading the statements is not a sufficient procedure for reporting on the results of applying agreed-upon procedures. Chapter 6 discusses agreed-upon procedures engagements.

102.12 **Examination**

Examination engagements generally involve: (a) evaluating the preparation, the support underlying the assumptions, and the presentation of the prospective financial statements for conformity with AICPA presentation guidelines and (b) issuing an examination report. The examination report expresses a positive opinion on whether the assumptions provide a reasonable basis for the prospective financial statements and whether the prospective statements conform with AICPA presentation guidelines. Chapter 7 discusses examination engagements.

Which Engagement Is Appropriate for Your Client?

102.13 The most important question affecting how practitioners select the appropriate engagement is whether the presentation is intended for third-party use. The answer to that question determines what authoritative literature applies and, in turn, what performance and reporting standards apply to the engagement. If the prospective presentation is intended for third-party use, practitioners should compile, examine, or apply agreed-upon procedures to the presentation. If the prospective presentation is not intended for third-party use, less restrictive standards apply. In that instance, the authors believe that practitioners will most often provide assembly services.

102.14 Section 201 discusses the factors to consider when recommending the type of service.

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[2] The AICPA's Auditing Standards Board (ASB) and Accounting and Review Services Committee (ARSC) have undertaken projects to clarify the attestation standards and the compilation and review standards, respectively, similar to the project to clarify the auditing standards. The breadth of the projects will result in significant changes to practice. See the discussion of these projects in section 109.

[3] Amendments to SSAE No. 10 are discussed beginning at paragraph 106.2.

[4] As noted previously, the ASB has a project to clarify the attestation standards. The revised attestation standards will adopt the clarified format that provides for separate sections for introductory material, definitions, objectives, requirements, and application guidance in the standards. When effective, the clarified attestation standards will supersede SSAE Nos. 10 through 17. See section 109.

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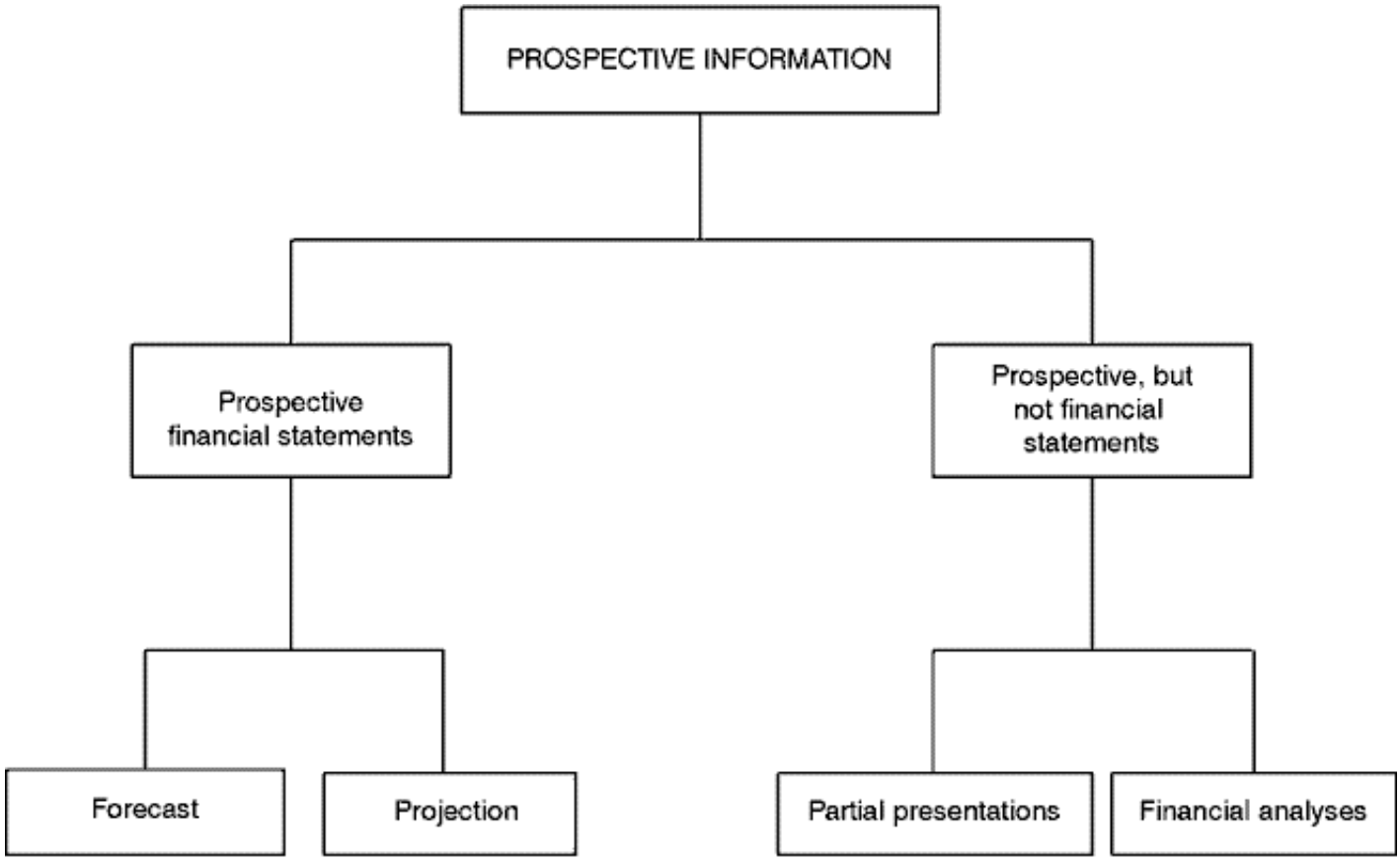
103 Types of Prospective Financial Information

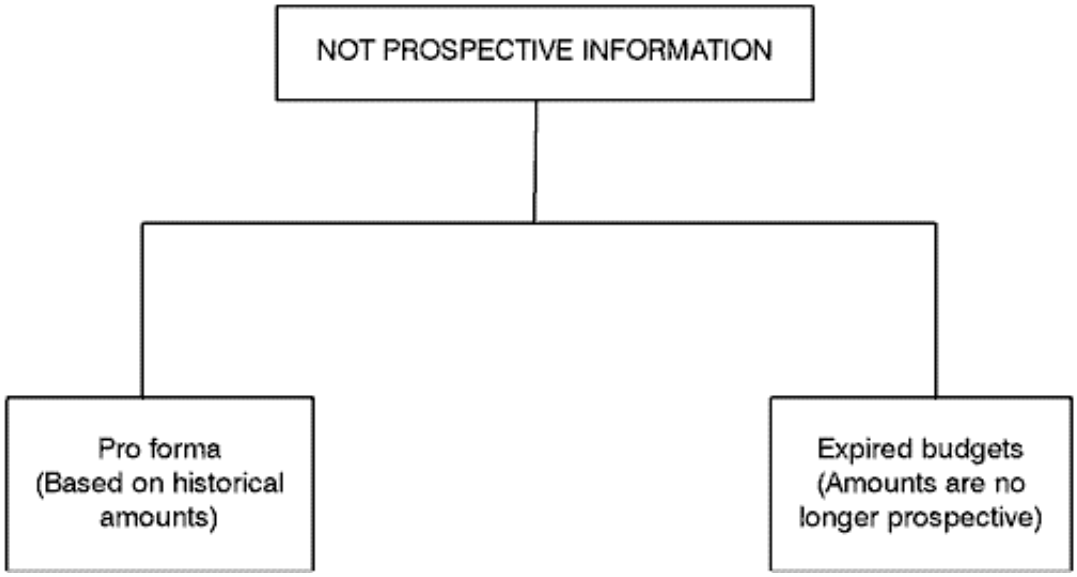
103.1 There are many types of prospective financial information. Prospective financial information may be presented as a complete set of prospective financial statements. There are two types of prospective financial statements: financial forecasts and financial projections. However, there are two other kinds of prospective financial information that are *not* prospective financial statements: partial presentations and financial analyses. Finally, there also are two types of presentations that look like prospective financial information but are not: prospective presentations for wholly expired periods (for example, budgets for expired periods) and pro forma financial presentations.

103.2 Each type of prospective presentation is appropriate for different uses. (See section 104.) Accordingly, it is essential to understand what each type of presentation is, how it differs from the others, and how each may be used under the AICPA standards. Exhibit 1-1 summarizes the six types of presentations.

Exhibit 1-1

Types of Presentations





Prospective Financial Information

103.3 In a broad context, prospective financial information is any financial information about the future. The information may be presented as complete financial statements or limited to one or more elements, items, or accounts.

Prospective Financial Statements

103.4 Prospective financial statements, as defined by the AICPA *Guide*, Paragraph 3.03, are a subset of prospective financial information.

> *Prospective financial statements.* Prospective financial information that presents financial position, results of operations, and cash flows. They are either financial forecasts or financial projections including the summaries of significant assumptions and accounting policies. Although prospective financial statements may cover a period that has partially expired, statements for periods that have completely expired are not considered to be prospective financial statements. Pro forma financial statements and partial presentations are not considered to be prospective financial statements.

103.5 Thus, any financial information about the future is considered to be prospective financial information. Prospective financial information includes prospective financial statements and partial presentations. Services on such prospective presentations are covered by the AICPA *Guide*. Financial analyses are not currently covered by AICPA literature.

Financial Statement Characteristics

103.6 Prospective financial statements have four characteristics. If a presentation lacks any one of the four, it is not a prospective financial statement. Prospective financial statements should—

a. Include certain minimum items.

b. Cover a future period.

c. Be prepared for an entity.

d. Be the responsibility of the responsible party.

103.7 **Minimum Items**

According to Appendix A of AT 301 (AT 301.68), the minimum items that are required, to the extent that they are applicable, for prospective financial statements are as follows: [5]

• Minimum Financial Statement Elements.

•• Sales or gross revenue.

•• Gross profit or cost of sales.

•• Unusual or infrequently occurring items.

•• Provision for income taxes.

•• Income from continuing operations.

•• Discontinued operations or extraordinary items. [6]

•• Net income.

•• Basic and fully diluted earnings per share (only necessary for publicly held companies).

•• Significant changes in financial position.

• Required Disclosures.

•• A description of what the responsible party intends the prospective financial statements to present, a statement that the assumptions are based on the responsible party's judgment at the time the prospective information was prepared, and a caveat that the prospective results may not be achieved.

•• Summary of significant assumptions.

•• Summary of significant accounting policies.

103.8 **Cover a Future Period**

The second characteristic of prospective financial statements is that the presentation covers a future period. Prospective financial statements might cover a day, a year, or a number of years. Although there is no minimum or maximum time period, the AICPA *Guide* encourages presentations of financial forecasts that do not exceed three to five years except under special circumstances. The periods need not correspond to fiscal years or be divided into one-year segments.

103.9 **Be Prepared for an Entity**

The third characteristic of prospective financial statements is that they should be prepared for an entity. AT 301.08(e) describes an *entity* as any unit that either exists or will be formed, for which financial statements could be prepared in accordance with GAAP or a special purpose framework (such as the cash or tax bases of accounting). Thus, an entity can be an individual; a corporation or partnership; a trust, estate, or association; or a governmental unit.

103.10 Prospective financial statements can only be prepared for entities. An entity need not have been formed at the time that the prospective statements are prepared; in fact, prospective financial statements may be prepared in an effort to raise capital for a proposed enterprise. An entity need not prepare historical financial statements or even maintain the data to do so for it to present prospective financial statements (although it might be difficult to prepare prospective financial statements without such data). Rather, entities should be able, in theory, to prepare historical financial statements. For example, a corporation could present prospective financial statements because corporations can prepare historical financial statements in conformity with GAAP or a special purpose framework. GAAP historical financial statements could not be prepared for certain operations, however, and, in those instances, prospective financial statements could not be prepared either. For example, complete GAAP financial statements could not be prepared for a machine (because a machine owns no assets and has no equity), and thus prospective financial statements could not be prepared for a machine.

103.11 **Responsible Party**

The fourth characteristic of prospective financial statements is that they are the responsibility of the responsible party. AT 301.08(g) defines *responsible party* as follows:

> The person or persons who are responsible for the assumptions underlying the prospective financial information. The responsible party usually is management, but it can be persons outside of the entity who do not currently have the authority to direct

operations (for example, a party considering acquiring the entity).

The responsible party can only be management or persons who expect to direct operations during the prospective period, i.e., prospective management. Practitioners cannot be responsible parties because, no matter how heavily involved they may be in identifying key factors, developing assumptions, and assembling the presentation, they cannot be sure of management's plans and intentions and will not run the entity to meet those plans during the period. Thus, they cannot assert that the presentation presents the expected conditions and course of action (or the expected conditions and course of action given a hypothetical assumption) during the prospective period.

Financial Analyses

103.12 Occasionally, practitioners are asked to develop assumptions representing possible courses of action for management's consideration and to prepare a financial analysis depicting recommendations. For example, an entity may want to open a restaurant on property it owns and might engage a practitioner to consider the types of restaurants the entity might construct and run, analyze possible results, and recommend a course of action. The resulting financial analysis may look like prospective financial statements. Because the practitioner, not the persons who expect to run the entity, takes responsibility for the assumptions, however, the presentation is neither a forecast nor a projection. AT 301.06 and the AICPA *Guide* refer to such a presentation as a *financial analysis* and state that it should *not* be called, or used as, a forecast or projection unless the responsible party (i.e., current or prospective management) adopts the assumptions and takes responsibility for them. (Also, see the discussion of financial analyses in section 805.)

Partial Presentations

103.13 Partial presentations are not prospective financial statements because they do not present all of the applicable minimum financial statement elements listed in paragraph 103.7 and, thus, do not have the first characteristic of prospective financial statements. AT 301.08(b) and the AICPA *Guide*, Paragraph 3.06, define *partial presentations* as presentations of prospective financial information that exclude one or more of the applicable minimum items listed at paragraph 103.7 that are required for prospective financial statements.

103.14 Partial presentations are not ordinarily appropriate for general use; thus, they should be restricted for use by specified parties who will be negotiating directly with the responsible party. Examples of partial presentations are sales forecasts (because they present only sales and omit the other items), tax projections that do not disclose significant changes in financial position, forecasted capital expenditures, and forecasts that include operating income but do not consider administrative costs or applicable income taxes.

Pro Forma Financial Information

103.15 Pro forma financial statements are not prospective financial statements because they do not cover a future period. (See paragraph 103.8.) Pro forma financial statements are essentially historical financial statements adjusted for a prospective transaction.[7]

103.16 Paragraph 2.03 of the AICPA *Guide* explains that the objective of financial presentations called “pro forma information,” is to show what the significant effects a consummated or proposed transaction (or event) that occurred at an earlier date might have been on historical financial information. Although pro forma presentations may look like prospective presentations, because pro forma statements are essentially historical statements and do not purport to be prospective financial statements, neither AT 301 nor the AICPA *Guide* apply to those presentations.

Budgets for Expired Periods

103.17 Budgets prepared for expired periods are not prospective financial statements because, similar to pro forma financial statements, they do not cover a future period. Last year's budget is no longer prospective financial information (and practitioners whose names are associated with budgets after the period has expired, for example, in budget-to-actual comparisons, would not fall under AICPA rules for prospective financial information). If any part of the period covered by the financial statement is in the future, however, the presentation is prospective. Thus, a presentation for the year ending December 31, 20X5, is prospective if it is presented in 20X4 or any time up to December 30, 20X5, but is not prospective if it is presented on or after December 31, 20X5.

Types of Prospective Financial Statements—Forecasts and Projections

103.18 **Definitions**

As shown in Exhibit 1-1, there are two kinds of prospective financial statements: *financial forecasts* and *financial projections*. AT 301.08(c) and (d) defines those terms 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 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. If a forecast contains a range, the range is not selected in a biased or misleading manner (for example, a range in which one end of the range 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 that begins, for instance, “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.

Both financial forecasts and financial projections may range from presentations consisting of a complete set of financial statements, i.e., balance sheet, statement of income and retained earnings, and statement of cash flows, to summarized presentations consisting of at least the applicable minimum financial statement elements listed in paragraph 103.7.

103.19 In essence, the definitions of forecast and projection are as follows: a forecast represents what the responsible party thinks is going to happen; a projection represents a “what if” analysis. There is an analogous situation in historical financial statements: traditional historical financial statements represent what did happen; pro forma financial statements represent what would have happened given the occurrence of a specific event. Thus, if the responsible party believes that the prospective results (presented as either a single point estimate or a range) represent what it expects to happen, it can characterize the presentation as a forecast. If the responsible party believes that one or more assumptions (even if presented as a range) do not represent its expectations, then those assumptions are considered hypothetical, and the presentation is a projection.

103.20 **Types of Assumptions—The Building Blocks for Forecasts and Projections**

There are three types of assumption: (a) those that are expected to happen, (b) those that are hypothetical (used to portray a “what if” scenario in a projection), and (c) those that would be expected to occur if the hypothetical assumption occurred (used in a projection). All significant assumptions in a forecast are expected to occur (although that does not mean that the responsible party is certain of the results but, rather, that based on its plans, it believes those results will occur). In a projection, one or more assumptions are hypothetical, other assumptions are expected based on the hypothetical assumption, and still other assumptions may be expected.

103.21 **Hypothetical Assumption**

A *hypothetical assumption* (as used in the preceding definition of a financial projection) is defined in AT 301.08(f) and the AICPA *Guide* at Paragraph 3.08. The guidance states that a hypothetical assumption is used to present a condition or course of action that is not necessarily expected to occur, but that is consistent with the purpose of a financial projection or a partial presentation of projected information.

103.22 The term *hypothetical assumption* is confusing to some people. They consider that all assumptions, by their nature, are hypothetical, and thus the term does not clearly distinguish one type of assumption from another. As a result, they believe that the distinction between forecasts and projections is unclear and largely semantic. As used here, the term *hypothetical assumption* refers to an assumption other than one that is expected to occur; it is a “what if” assumption. The responsible party does not select the assumption to reflect an expected condition or course of action. Rather, the responsible party's intent in selecting a hypothetical assumption is to present a condition or course of action that it wants to consider or analyze.

103.23 For example, an entity may wish to get a bank loan but is unsure whether it will receive one.

The entity might prepare a projection assuming that it receives the loan and take that projection to a bank to negotiate the loan. The assumption regarding the loan is, therefore, a hypothetical assumption because the company does not necessarily expect to get the loan or the terms assumed in the presentation (although the bank *might* grant the loan at the terms assumed). All other assumptions would be expected to occur if the hypothetical assumption occurred, i.e., if the loan were granted. (However, if the entity were unwilling to negotiate any other terms of the loan and would accept the loan only under the assumed terms, the presentation could be considered to be a forecast. See discussion beginning at paragraph 202.40.)

103.24 Or, a company may prepare a break-even analysis for the coming year even though it expects to make a profit. The break-even sales volume is a hypothetical assumption (not necessarily expected to occur) selected for analysis, which is the purpose of the projection. All other assumptions would be expected to occur if the sales volume were at the break-even level (even though sales at that level are unlikely).

103.25 In the bank loan example in paragraph 103.22, which assumption is hypothetical: getting the loan, the amount of the loan, or the terms? Determining the hypothetical assumption would depend on the circumstances. If the responsible party were unsure whether it would be granted a loan, the granting of the loan would be the hypothetical assumption, and the loan amount and terms would be expected given the granting of the loan. If the responsible party thought that it would get a loan but was unsure of the amount, the granting of a loan would be expected, the loan amount would be hypothetical, and the terms would be expected given the hypothetical assumption. If, in the latter case, the responsible party could not estimate the terms either, then the amount and the terms would be hypothetical assumptions.

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[5] Paragraphs 303.6, 304.9, and 304.29 discuss the effect of omitting any of the minimum financial statement elements or required disclosures.

[6] In January 2015, the FASB issued ASU No. 2015-01, *Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items*, which eliminates from GAAP the concept of extraordinary items. ASU 2015-01 is effective for all entities for fiscal years and interim periods within those years beginning after December 15, 2015, with early adoption and retrospective application permitted.

[7] SSAE No. 10 (AT 401) and SSARS No. 14 (AR 120) contain guidance on performing procedures and reporting on pro forma presentations. The guidance is discussed in section 802.

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104 Uses of Prospective Financial Information

104.1 The intended use of prospective financial statements generally determines what type of prospective financial statements to present. The decision is not necessarily based on the type of entity presenting the statements (e.g., any of the following could, in theory, present either a forecast or projection: an entity proposed but not formed, an entity in its first fiscal year, a long-established entity with stable operations, or an entity in a cyclical business). It is important, therefore, to understand the intended uses of prospective financial statements. The AICPA guidance states that financial forecasts are appropriate for any use, but other types of presentations are not ordinarily appropriate for general use. There are three types of uses discussed in the AICPA *Guide*: *general use*, *limited use*, and *internal use* (which is a class of limited use). Exhibit 1-2 summarizes the appropriate uses for each type of prospective information. The three types of uses are described in the following paragraphs.

Exhibit 1-2

Uses of Prospective Financial Information

Type of Prospective Presentation	Appropriate Uses		
	General Use	Limited Use	Internal Use
Forecast	Yes	Yes	Yes
Projection	No	Yes	Yes
Partial Presentation	No	Yes	Yes
Financial Analysis	No	Yes	Yes

General Use

104.2 General use refers to use by persons with whom the responsible party is not negotiating directly. The *number* of users is irrelevant in determining whether a use is general. (It differs from SEC rules in that respect.) A user is considered to be a general user if he does not negotiate directly with the responsible party. A presentation to even one passive user would be considered to be a general use of prospective financial statements. Some of the more common types of general uses are as follows:

- A presentation to a group of doctors for an investment in a medical building.

- An offering of tax-exempt revenue bonds.

- A budget sent to unit owners in a condominium or cooperative housing development.

- A presentation to a creditor's committee in bankruptcy proceedings in which the committee can either take or leave the deal.

- An offering of debt or equity under SEC regulations.

Limited Use

104.3 Limited use refers to use only by the entity or by the entity and persons with whom it is negotiating directly. Persons with whom the entity is negotiating directly are interested in the same hypothetical assumptions as the responsible party, can ask questions of the responsible party, and will influence the outcome of the negotiations. Again, the number of persons involved is irrelevant in determining whether a use is considered to be limited. Rather, the decision is made based on whether the user is negotiating directly with the responsible party. (Realistically, however, there is a limit to how many people can negotiate directly with the responsible party given constraints on its time and energy.) Accordingly, use can be considered limited even if there are a number of different users all of whom negotiate directly with the responsible party. It is not enough that the user can ask questions of the responsible party and expect an answer; the user should be negotiating with the responsible party, and thus exert some clout over the ultimate outcome of the negotiations. If the user is given a “take it or leave it” deal, no matter how many questions it can ask of the responsible

party, the user is considered to be a general user. Common limited uses are as follows:

- Financing negotiations with a bank.
- Financing negotiations with a number of banks, one at a time, to try to get the best deal.
- Private placement of debt.
- Merger negotiations.
- Labor contract negotiations.
- Management analysis of a possible change in operations.
- Regulatory proceedings.

Presentations Appropriate for General and Limited Use

104.4 Because general users do not negotiate directly with the responsible party and ask it questions, the presentation that is most useful to them is one that presents the responsible party's expectations, i.e., a forecast. Financial projections may be used by limited users because the users may ask questions about the hypothetical assumptions and change the fact situations depicted in the projection. Therefore, AT 301.11 specifically states that a practitioner should not consent to the use of his or her name in conjunction with a financial projection that the practitioner believes will be distributed to those not negotiating directly with the responsible party. Projections may be presented to general users only if the projections are used to supplement a forecast for the same period.

104.5 In other words, forecasts are analogous to historical financial statements. One depicts what is expected to happen, while the other depicts what did happen. And, like historical financial statements, forecasts are useful to any reader. Forecasts can be used by general or limited users. Projections are analogous to pro forma financial statements. Where one depicts what would happen, the other depicts what would have happened. Like pro forma statements, projections are useful only in direct negotiations or as a supplement to a general-use presentation.

104.6 Other forms of prospective financial information also are limited-use presentations because, like projections, they do not tell the whole story. Partial presentations omit some of the minimum items that a user might need to know. Financial analyses omit a discussion of the responsible party's plans, which would affect the ultimate realization of prospective amounts. Accordingly, use is limited to those persons who are negotiating directly with the responsible party and can get the necessary information and challenge the assumptions.

104.7 Some practitioners ask whether presentation of a projection for the same period as a forecast is contradictory, however. They suggest that including the projection casts doubt on management's ability to represent that the forecast reflects the expected conditions and course of action. The authors believe that including a projection is not contradictory. They believe that a forecast is not a prediction, but information about management's plans and expectations, which may or may not come true. The supplementary projection functions like a sensitivity analysis. In effect, the presentation says, “this is what we believe will happen based on the way we intend to run the company, but here is what would happen if the following hypothetical assumption occurred.”

104.8 The AICPA *Guide* encourages preparers to analyze the relative effect of variations in the major underlying assumptions (Paragraphs 6.37 and 6.38 of the AICPA *Guide*) and states that significant assumptions that are particularly sensitive should be identified (Paragraph 8.24 of the AICPA *Guide*). Preparing a supplementary projection is one method of accomplishing both goals. For example, the expected sales volume for a particular entity might be considered a sensitive assumption because it affects sales, cost of sales, commission expense, accounts receivable, and inventory. One way to determine the sensitivity of the expected sales volume and to analyze the effect of variations would be to prepare supplementary projections based on variations in the expected sales volume. The authors believe that supplementary projections are useful whenever a variation in a sensitive assumption would affect a number of different items in the forecast.

Internal Use

104.9 Internal use refers to use solely by the responsible party and is a form of limited use. Occasionally, determining whether users are internal users requires judgment. In determining whether use is internal, practitioners should consider whether the user's interests are consistent with the responsible party's. (See the discussion in Chapter 22, footnote 1 of the AICPA *Guide*.) For example, if the user is an absentee owner and the responsible party is a nonowner manager, their interests would be considered to be potentially inconsistent because the manager is responsible for managing the investment, and the shareholder is interested in how the manager is managing his investment. Accordingly, in that case, the use would not be considered to be internal. (In fact, such a use would be considered to be general use when the presentation is not related to negotiations between the manager and the shareholder.)

104.10 The distinction between internal and other forms of limited use is more important in determining the appropriate type of practitioners' services than in determining the correct type of presentation. Chapter 4 discusses internal use engagements.

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105 How to Use *PPC's Guide to Forecasts and Projections*

105.1 Chapters 2-22 of this guide provide the following detailed guidance on the types of prospective financial presentations and the services that practitioners may provide on them:

- Chapter 2—*Engagement Administration*

- Chapter 3—*Form and Presentation*

- Chapter 4—*Internal Use Engagements*

- Chapter 5—*Compilation Engagements*

- Chapter 6—*Agreed-upon Procedures Engagements*

- Chapter 7—*Examination Engagements*

- Chapter 8—*Other Presentations*

- Chapter 22—*Considerations for Recent Accounting Principles*

While the authors have made every effort to discuss the important aspects of the AICPA literature on prospective financial statements, *PPC's Guide to Forecasts and Projections* is not a substitute for either individual study of authoritative literature or sound professional judgment. Users of this guide also should consult the AICPA *Guide*.

105.2 In addition, this guide is designed for nonpublic entities. Although the AICPA's standards for attestation engagements (the SSAEs) for practitioners' services on prospective financial statements apply to public and nonpublic companies, the independence rules for practitioners performing attest services for public companies, as prescribed by the SEC and PCAOB, are different from those of the AICPA. Also, the SEC has issued additional guidance on requirements for pro forma presentations. Practitioners with public company clients may need to modify their reports to refer to standards established by the PCAOB rather than the AICPA. Accordingly, users of this guide with public company clients also should refer to SEC and PCAOB guidance in these areas.

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106 A Survey of the Authoritative Literature

106.1 Exhibit 1-3 summarizes the existing and superseded AICPA technical literature that applies to practitioners' services on prospective financial information as of February 2015. Paragraphs beginning at 106.2 describe the scope and authority of the documents.

Exhibit 1-3

AICPA Literature on Prospective Financial Information

CURRENT LITERATURE

Statement on Standards for Attestation Engagements (SSAE) No. 10 (AT 301), as amended, establishes procedural and reporting standards for three types of engagements on prospective financial statements that are reasonably expected to be used by third parties—compilation, examination, and applying agreed-upon procedures. (See the discussion beginning at paragraph 106.5.)

SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements* (AT 20). This standard defines the degree of responsibility imposed on the practitioner when certain imperatives (such as *must*, *is required*, and *should*) are used in the attest standards. (See the discussion beginning at paragraph 106.11.)

SSAE No. 14, *SSAE Hierarchy* (AT 50). This standard identifies the body of attestation literature and clarifies the authority of attestation publications issued by the AICPA and others. It specifies the attestation publications that the practitioner must comply with and those that the practitioner should be aware of when performing an engagement. The standard also amends the 11 attestation standards to conform them to the terms used in SSAE No. 13. (See the discussion of this standard beginning at paragraph 106.14.)

AICPA *Guide: Prospective Financial Information* (the AICPA *Guide*) [a] —establishes AICPA presentation guidelines for and provides illustrative guidance on prospective financial information

(prospective financial statements and partial presentations). It incorporates SOPs 89-3, 90-1, and 92-2, SSAE No. 10, as amended, SSAE No. 13, SSAE No. 14, and SSAE No. 17.

WITHDRAWN LITERATURE

Statement of Position 89-3, *Questions Concerning Practitioners' Services on Prospective Financial Statements*—provided guidance on six frequently encountered situations in which questions arise. The guidance was incorporated in various chapters of the AICPA *Guide*.

Statement of Position 90-1, *Accountants' Services on Prospective Financial Statements for Internal Use Only and Partial Presentations*—provided authoritative procedural and reporting guidance on internal use presentations and partial presentations. The guidance was incorporated in the AICPA *Guide*.

Statement of Position 92-2, *Questions and Answers on the Term "Reasonably Objective Basis" and Other Issues Affecting Prospective Financial Statements*—provided guidance on how to determine whether there is a reasonably objective basis for a forecast, the length of the forecast period, and disclosure of long-term results beyond the forecast period. The guidance was incorporated in Chapter 7 of the AICPA *Guide*.

SUPERSEDED LITERATURE

Authoritative Statement, *Financial Forecasts and Projections* (the AICPA Statement or the Statement)—established procedural and reporting standards for three types of engagements on prospective financial statements that are reasonably expected to be used by third parties—compilation, examination, and applying agreed-upon procedures. The AICPA Statement was incorporated into SSAE No. 1 (AT 200).

Statement on Standards for Attestation Engagements No. 4 (SSAE No. 4, *Agreed-Upon Procedures Engagements*)—provided guidance for engagements to apply agreed-upon procedures to financial information, including prospective financial information. Appendix A of SSAE No. 4 amended the sections of the AICPA Statement that dealt with agreed-upon procedures.

Ethics Rule of Conduct 201E—prohibited vouching for the achievability of a forecast (or projection).

Ethics Interpretation 201-2—provided guidance for prospective presentations not covered by the technical literature, i.e., partial presentations and internal use presentations.

MAS Guideline No. 3—provided guidelines for preparing forecasts. The guidance in that document was expanded to include projections, and that expanded guidance was incorporated in the AICPA *Guide for Prospective Financial Statements*.

SOP 75-4—established AICPA presentation guidelines for a forecast. The guidance in that document was revised and expanded to include projections, and that expanded guidance was incorporated in the AICPA *Guide for Prospective Financial Statements*.

Guide for a Review of a Financial Forecast—established guidelines for one level of service—a review—for one type of prospective financial statement—a forecast. The AICPA *Guide for Prospective Financial Statements* renamed the service "examination" and expanded the guidance to projections.

SOP, *Report on a Financial Feasibility Study*—required a review report on a forecast contained in a feasibility study to be consistent with the review report established in the forecast guide. The guidance was carried forward to the AICPA *Guide for Prospective Financial Statements*.

Guide for Prospective Financial Statements—established AICPA presentation guidelines for prospective financial statements and provided illustrative guidance on the three types of services described in the AICPA Statement.

Notes:

[a] As discussed in paragraph 102.6, the latest edition of the AICPA *Guide* is updated as of November 1, 2012.

Statement on Standards for Attestation Engagements

106.2 As of the date of this guide, the following attestation standards [8] have been issued:

• SSAE No. 10, *Attestation Standards: Revision and Recodification*—SSAE No. 10 is organized in the following sections:

•• AT 101—*Attest Engagements*. (This section provides the umbrella standards that govern all types of attestation engagements.)

•• AT 201—*Agreed-upon Procedures Engagements*.

•• AT 301—*Financial Forecasts and Projections*. This section establishes procedural and reporting standards for examinations, compilations, and agreed-upon procedures engagements on prospective financial statements that are reasonably expected to be used by third parties.

•• AT 401—*Reporting on Pro Forma Financial Information*.

•• AT 601—*Compliance Attestation*.

•• AT 701—*Management's Discussion and Analysis*.

• SSAE No. 11, *Attest Documentation*, [9] was issued in January 2002 and amends the documentation requirements of SSAE No. 10. Those documentation requirements are discussed further in section 212 of this guide.

• SSAE No. 12, *Amendment to Statement on Standards for Attestation Engagements No. 10*, Attestation Standards: Revision and Recodification, [9] was issued in September 2002 and also amends SSAE No. 10 to clarify the relationship of the SSAEs to quality control standards. The amendment clarifies that although an effective quality control system is conducive to compliance with attestation standards, deficiencies in or noncompliance with a firm's quality control system do not, in and of themselves, indicate that an engagement was not performed in accordance with the attestation standards.

• SSAE No. 13 (AT 20), *Defining Professional Requirements in Statements on Standards for Attestation Engagements*, defines terms used in the SSAEs to impose professional requirements. This standard is discussed in more detail in paragraph 106.11.

• SSAE No. 14 (AT 50), *SSAE Hierarchy*, which is discussed in more detail beginning at paragraph 106.14, identities the body of attestation literature and clarifies the authority of attestation publications.

• SSAE No. 15 (AT 501), *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, establishes standards and provides guidance to practitioners performing an examination of a nonissuer's internal control over financial reporting (internal control) that is performed as an integrated audit (an audit of an entity's financial statements and an examination of its internal control). SSAE No. 15 is

discussed in detail in *PPC's Guide to Nontraditional Engagements*.

• SSAE No. 16 (AT 801), *Reporting on Controls at a Service Organization*, provides guidance relating to reporting on the internal controls of a service organization and superseded the guidance for service auditors that formerly resided in the auditing standards. It is effective for service auditors' reports for periods ending on or after June 15, 2011. SSAE No. 16 is discussed in *PPC's Guide to Nontraditional Engagements*.

• SSAE No. 17, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence is Impaired*, [9] revises AT 301 to permit, but not require, the practitioner to disclose the reason(s) his or her independence is impaired in a report on compiled prospective financial statements. (See the discussion at paragraph 106.8.)

106.3 The AICPA also issues SSAE interpretations that are codified in the AT section of *Professional Standards* following the AT section they interpret. The interpretations explain sections of standards that are ambiguous or application of the standards in situations not envisioned when they were originally issued. The interpretations are not enforceable under the code of conduct, but practitioners should be prepared to justify departing from them if their work is challenged.

106.4 **AT 101, *Attest Engagements***

AT 101 is the umbrella standard that governs all types of attestation engagements, including engagements on prospective financial statements. It contains a discussion of the general, fieldwork, and reporting standards for attest engagements. AT 101 also contains the attest documentation requirements. As discussed in the following paragraph, AT 301 contains the presumptively mandatory requirements for engagements related to prospective financial statements. However, practitioners should comply with the requirements in AT 101 in addition to those in AT 301.

106.5 **AT 301, *Financial Forecasts and Projections***

AT 301 contains specific guidance for compilation, examination, and agreed-upon procedures engagements related to forecasts and projections. AT 301's requirements are discussed throughout this guide; however, its principal provisions establish the following:

a. *Definitions of Forecasts and Projections.* Forecasts and projections are the two types of prospective financial statements. In essence, AT 301 defines a forecast as management's estimate of future results and defines a projection as the answer to a “what if” question. (Paragraphs beginning at 103.18 define forecasts and projections in detail.)

b. *Appropriate Uses of Prospective Financial Information.* AT 301 states that, ordinarily, only forecasts are appropriate for general use; projections and other types of prospective information, e.g., partial presentations, ordinarily are appropriate only for limited use.

c. *Three Levels of Service Practitioners May Provide on Prospective Financial Statements for Third-party Use.* AT 301 states that, whenever the prospective financial statements are for third-party use and practitioners either assemble and submit the prospective financial statements or report on them, they should examine, compile, or apply agreed-upon procedures to them. AT 301 also establishes procedural and reporting standards for each type of service.[10]

d. *Instances When Practitioners Should Not Provide Services on Prospective Financial Statements for Third-party Use.* AT 301 states that practitioners should not provide services on prospective statements that are liable to be misleading, for example, statements that do not include the underlying assumptions or projections that will be distributed to other than limited users.

106.6 **Does AT 301 Require Companies to Prepare Prospective Financial Statements?**

No. AT 301 does not require or recommend presentation of prospective financial statements. AT 301 establishes (a) the form of the prospective information if clients decide to present it and (b) standards for practitioners who perform services on prospective financial statements that clients have decided to present.

106.7 **Does AT 301 Apply to Litigation Support Services?**

Generally, AT 301 does not apply to litigation support services, which are generally engagements when a practitioner acts as an expert witness in pending or potential legal proceedings. (See AT 301.05.) According to AT 301, the primary reason the exception is allowed is that the practitioner's work will usually be subject to detailed analysis and each party in the dispute can challenge it. AT 301 does apply, however, when (a) practitioners are specifically engaged to issue or do issue a compilation, agreed-upon procedures, or examination report on prospective financial statements, or (b) prospective financial statements are used by third parties who are not able to analyze and challenge practitioners' work, for instance, creditors who are presented with prospective financial statements to secure their agreement to a plan of reorganization.

106.8 **Amendment to AT 301 Made by SSAE No. 17, *Reporting on Compiled Prospective Financial Statements When the Practitioner's Independence Is Impaired***

If a practitioner has been engaged to compile prospective financial information for an entity for which he or she is not independent, AT 301.23 requires the practitioner to indicate the lack of independence

in a separate paragraph of the report. SSAE No. 17 amended AT 301.23 to also permit, but not to require, the practitioner to disclose the reason(s) for the independence impairment. If the practitioner elects to disclose a description of the reasons independence is impaired, all of the reasons independence is impaired must be disclosed. SSAE No. 17 provides examples of how to describe independence impairments. See the discussion in section 506.

106.9 **AT 201, *Agreed-Upon Procedures Engagements***

AT 201 contains specific guidance for practitioners performing agreed-upon procedures engagements. For agreed-upon procedures engagements related to forecasts and projections, practitioners will need to follow the guidance in both AT 201 and AT 301. Chapter 6 contains guidance on performing these engagements.

106.10 **AT 401, *Reporting on Pro Forma Financial Information*** [11]

AT 401 provides performance and reporting guidance to practitioners who are engaged to issue or do issue an examination or review report on pro forma financial information. Section 802 contains guidance relating to reporting on pro forma financial information.

106.11 **SSAE No. 13, *Defining Professional Requirements in Statements on Standards for Attestation Engagements* (AT 20)**

This standard clarifies the meaning of certain terms used in SSAEs and defines the terminology that the ASB uses to describe the degrees of responsibility that the professional requirements impose on practitioners.

106.12 This standard defines the degree of responsibility imposed on the practitioner when certain imperatives (such as *must*, *is required*, and *should*) are used in the attestation standards. (The contents of the SSAEs contain professional requirements along with explanatory material.) The practitioner's degree of responsibility in complying with professional requirements can be identified through two categories.

- Unconditional requirements. Unconditional requirements are those that a practitioner must follow in all cases if the circumstances apply to the requirement. These requirements use the words “must” or “is required.”

- Presumptively mandatory requirements. Practitioners are also expected to comply with presumptively mandatory requirements if the circumstances apply to the requirement; however, in rare situations, a departure from the requirement is allowed if the practitioner documents the justification and how alternative procedures that were performed were sufficient to achieve the objectives of the requirement. Presumptively mandatory requirements are identified by the word “should.” If a SSAE uses the words “should consider” for a procedure, the consideration of the procedure is presumptively required.

106.13 Explanatory material represents material that provides additional guidance on professional requirements or identifies other procedures or actions. A practitioner is not required to perform other procedures or actions that are identified through explanatory material. These items require the practitioner's understanding and professional judgment regarding their applicability. Explanatory material is identified through the words “may,” “might,” and “could.”

106.14 **SSAE No. 14, *SSAE Hierarchy* (AT 50)**

This standard identifies the body of attestation literature and clarifies the authority of attestation publications issued by the AICPA and others. It specifies the attestation publications that the practitioner must comply with and those that the practitioner should be aware of when performing an attestation engagement. The standard also amended the 11 general, fieldwork, and reporting standards to conform them to the terms used in SSAE No. 13. (See paragraph 106.16.)

106.15 SSAE No. 14 establishes three levels in the SSAE hierarchy:

a. *Attestation Standards.* Attestation standards consist of the 11 general, field work, and reporting standards and Statements on Standards for Attestation Engagements (SSAEs) issued by the AICPA's Auditing Standards Board (ASB). SSAEs are codified within the framework of the 11 standards. The AICPA *Code of Professional Conduct* requires members to comply with SSAEs. SSAE No. 14 also states that when a practitioner departs from a presumptively mandatory requirement, the practitioner must document the justification for the departure and how alternative procedures that were performed achieved the objectives of the requirement.

b. *Attestation Interpretations.* Attestation interpretations are not attestation standards, but rather recommendations on applying the SSAEs. Attestation interpretations include Interpretations of the SSAEs, appendixes to the SSAEs, attestation guidance in AICPA Audit and Accounting Guides and AICPA attestation Statements of Position. SSAE No. 14 states that practitioners should be aware of and consider applicable attestation interpretations. If the practitioner does not apply an attestation interpretation, the practitioner should be prepared to explain how he or she complied with the underlying SSAE provisions.

c. *Other Attestation Publications.* Other attestation publications have no authoritative status but may help practitioners understand and apply the SSAEs. Other attestation publications include AICPA attestation publications not referred to in items a. and b.; attestation articles in the *Journal of Accountancy*, other professional journals, and the AICPA *CPA Letter*; continuing professional education programs and other instructional materials, textbooks, guide books, attest programs, and checklists; and attestation literature published by state CPA societies, other organizations, and individuals. If practitioners apply the guidance in other attestation publications, they should

satisfy themselves that the guidance is both relevant and appropriate. *Relevance* refers to whether the guidance is applicable to the circumstances of a particular engagement. Indicators of appropriateness include the extent to which the publication is recognized as being helpful and the professional qualifications of its author or issuer relating to attestation matters. There is a presumption that other attestation publications reviewed by the AICPA Audit and Attest Standards staff are appropriate.

106.16 SSAE No. 14 also amended the 11 attestation standards to conform them to the terms used in SSAE No. 13. Under SSAE No. 14 (AT 50.02), all 11 attestation standards use the word *must* and are therefore unconditional requirements. Those standards, as amended, are as follows:

General Standards

a. The practitioner must have adequate technical training and proficiency to perform the attestation engagement.

b. The practitioner must have adequate knowledge of the subject matter.

c. The practitioner must have reason to believe that the subject matter is capable of evaluation against criteria that are suitable and available to users.

d. The practitioner must maintain independence in mental attitude in all matters relating to the engagement.

e. The practitioner must exercise due professional care in the planning and performance of the engagement and the preparation of the report.

Standards of Fieldwork

a. The practitioner must adequately plan the work and must properly supervise any assistants.

b. The practitioner must obtain sufficient evidence to provide a reasonable basis for the conclusion that is expressed in the report.

Standards of Reporting [12]

a. The practitioner must identify the subject matter or the assertion being reported on and state the character of the engagement in the report.

b. The practitioner must state the practitioner's conclusion about the subject matter or the assertion in relation to the criteria against which the subject matter was evaluated in the report.

c. The practitioner must state all of the practitioner's significant reservations about the engagement, the subject matter, and, if applicable, the assertion related thereto in the report.

d. The practitioner must state in the report that the report is intended solely for the information and use of the specified parties under the following circumstances:

- When the criteria used to evaluate the subject matter are determined by the practitioner to be appropriate only for a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria.

- When the criteria used to evaluate the subject matter are available only to specified parties.

- When reporting on subject matter and a written assertion has not been provided by the responsible party.

- When the report is on an attestation engagement to apply agreed-upon procedures to the subject matter.

AICPA *Guide: Prospective Financial Information*

106.17 The AICPA *Guide: Prospective Financial Information* [13] (the AICPA *Guide*) incorporates and supplements the guidance in SSAE No. 10 (AT 301). The AICPA *Guide* does the following:

a. *Provides Guidance on Preparing Prospective Financial Statements.* It provides suggestions for improving effectiveness when preparing prospective financial statements. The AICPA *Guide* does not require either practitioners or clients to follow the suggestions.

b. *Establishes Presentation Guidelines.* The AICPA *Guide* establishes the equivalent of GAAP for prospective financial statements. Because the FASB has not expressed an intention to set standards for prospective financial statements, the accounting and disclosure guidance in the AICPA *Guide* is the highest level of guidance that is expected to be issued.

c. *Provides Illustrative Material for the Matters Covered in AT 301.* The AICPA *Guide* provides additional illustrative material on topics contained in AT 301. It also discusses some areas not covered by AT 301 (for example, internal-use-only presentations).

d. *Provides Additional Guidance on Partial Presentations.* The AICPA *Guide* describes how the preparation and presentation guidelines for prospective financial statements apply to the unique aspects of partial presentations.

Other AICPA Literature

106.18 **Do the SSARS Apply to Compilations and Reviews of Prospective Financial Statements?**

No. SSARS No. 19 (AR 60.04) states *financial statements* are presentations of historical financial information within a financial reporting framework that communicate an entity's economic resources and obligations at a point in time. Because the definition specifies *historical* financial information, forecasts and projections are currently excluded from the scope of the SSARS. [14]

106.19 **Does Peer Review Cover Engagements on Prospective Financial Statements?**

Yes. The peer review program states that the scope of the review includes all engagements under the Statements on Standards for Attestation Engagements. The peer review program is discussed in section 203.

106.20 **Statements on Standards for Valuation Services**

When the practitioner is engaged to provide a service on prospective financial statements and, as part of that engagement, considers factors to estimate the value of a business, SSVS No. 1, *Valuation of a Business, Business Ownership Interest, Security, or Intangible Asset* does not apply. VS 100.05 specifically excludes services in which the practitioner estimates the value of a subject

interest as part of performing an attest engagement. The practitioner would be required to follow the requirements of SSAE No. 10 (AT 301).

106.21 Conversely, CPA valuation consultants commonly prepare prospective financial information as a part of providing valuation services. An interpretation to SSVS No. 1 (paragraph 74) states that if, in the course of performing a valuation under the Statement, a valuation analyst prepares prospective financial information (for example, as part of a discounted cash flow or discounted earnings analysis within the income approach), he or she is *not* required to examine or compile such information in accordance with the SSAEs. The authors believe that the interpretation is stating that the practitioner, not the client, takes responsibility for the presentation of prospective financial information in these circumstances, and therefore does not fall under the requirements of AT 301. In the event the CPA valuation consultant wishes to, or is engaged to, perform a compilation, examination, or agreed-upon procedures on the prospective presentation or issues such a report as part of the valuation engagement, he or she is not prohibited from providing such services. However, if the practitioner assembles and submits prospective financial statements (which, by definition is the client's responsibility, not the practitioner's) for third party use, AT 301 requires the practitioner to either compile, examine, or apply agreed upon procedures to the information.

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[8] The AICPA's Auditing Standards Board is currently revising and clarifying the attestation standards. See the discussion in section 109.

[9] SSAE Nos. 11, 12, and 17 are amendments to SSAE No. 10 and are not separately codified in the AT sections of the authoritative standards. All references to SSAE No. 10 in this guide are to SSAE No. 10, as amended by SSAE Nos. 11, 12, and 17.

[10] As discussed in paragraph 102.9, current-year budgets that are presented with interim historical financial statements are exempt from those requirements.

[11] SSARS No. 14, *Compilation of Pro Forma Financial Information*, provides guidance when a practitioner is engaged to compile or issues a compilation report on pro forma financial information. SSARS No. 14 is discussed in section 802.

[12] The reporting standards apply only when the practitioner issues a report.

[13] Revisions to the AICPA *Guide* are discussed at paragraph 102.5.

[14] The AICPA's Accounting and Review Services Committee (ARSC) is currently developing guidance for compilations of prospective financial information, which, when final, would move the guidance for such services from the SSAEs to the SSARS. Guidance for compilations of prospective presentations is not being carried forward in the project to clarify the attestation standards. See the discussions of these projects in section 109.

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107 Independence Considerations

107.1 Examination and agreed-upon procedures engagements for presentations of prospective financial information require that the practitioner be independent. Although independence is not required in compilation and assembly engagements for presentations of prospective financial information, the lack of independence must be disclosed in the report on a compilation engagement. [15] In addition, practitioners who report on other engagements for presentations of prospective financial information may choose to disclose the lack of independence, even though disclosure is not required. (The guidance the AICPA *Guide* provides in Paragraph 22.07 for engagements in which reporting is not required but the practitioner decides to issue a report is as follows: ". . . the practitioner's report would, if applicable, preferably indicate if the practitioner is not independent with respect to an entity on whose financial forecast he or she is providing services.") Paragraph 17.28 of the AICPA *Guide* says, "Whether or not the practitioner is independent is something he or she must decide as a matter of professional judgment." In addition, Footnote 40 to Chapter 17 of the AICPA *Guide* states, "In making a judgment about whether he or she is independent, the practitioner should be guided by the AICPA *Code of Professional Conduct*." [16] [17]

107.2 The AICPA rules governing independence are found in the AICPA *Code of Professional Conduct*.

AICPA Revises the *Code of Professional Conduct*

107.3 A revised AICPA *Code of Professional Conduct (Code)* was issued in 2014 and most of its provisions became effective December 15, 2014. The reformatting of the *Code* resulted in a number of structural improvements and some substantive revisions, while maintaining the substance of the existing AICPA ethics standards. This guide has been updated for the revised *Code*.

107.4 **New Structure and Numbering System**

The restructured guidance is divided into the following parts:

- *Part 1* applies to members in public practice.

• *Part 2* applies to members in business.

• *Part 3* applies to other members (such as retired or unemployed members).

107.5 A new numbering system begins with a single digit that identifies the part of the *Code* in which the content resides. For example, preface guidance begins with 0, Part 1 guidance begins with 1, etc. The next three-digit set of numbers identifies topics, and the third three-digit set of numbers identifies subtopics. A review of the table of contents for members in public practice, for example, presents the following:

• 1.230 Fees

• 1.230.010 Unpaid Fees

107.6 **Substantive Changes**

The substance of the requirements in the previous *Code* was maintained. However, in updating the *Code* the AICPA's Professional Ethics Executive Committee (PEEC) identified some areas as needing substantive revisions. The following are some of the areas that contain substantive changes:

• *Conceptual Framework.* Two conceptual frameworks are included: one for members in public practice and another for members in business.

• *Attest Client.* Because members do not have to be independent of all clients, PEEC developed a new definition of *attest client*.

• *Self-review Threat.* PEEC redrafted the definition of a *self-review threat* to include individuals who are currently employed by the firm but were previously associated with the client.

• *Ethical Conflicts.* The previous guidance on resolving ethical conflicts was nonauthoritative. Both Part 1 and Part 2 of the revised *Code* include discussions of ethical conflict resolution.

• *Use of AICPA Award Designation.* Previous guidance at Ethics Ruling 183 (ET 591.365-.366), "Use of the AICPA Personal Financial Specialist Designation," concluded that use of the PFS designation on a firm's letterhead and marketing material was permissible provided all partners or shareholders of the firm have the designation. This guidance now applies to any AICPA-awarded designation.

• *Loans and Lending Institutions.* The definition of a loan is changed to align with the FASB's definition. In addition, the term *financial institution* is changed to *lending institution*.

107.7 **Effective Date**

The revised AICPA *Code* was effective on December 15, 2014. The two new conceptual frameworks and related interpretations, however, will not be effective until December 15, 2015. [18] Application of two conceptual frameworks, one for members in public practice and another for members in business, is one of the most significant changes to the revised AICPA *Code*. The guidance that is effective on December 15, 2014, has been incorporated into this guide. The guidance that is effective December 15, 2015, will be incorporated in the next annual update of this guide. Firms can access the online version of the revised *Code* at **pub.aicpa.org/codeofconduct/Ethics.aspx**.

Common Independence Considerations in the AICPA *Code*

107.8 The AICPA rules governing independence are found in ET 1.200, *Independence*, of the revised AICPA *Code*. Exhibit 1-4 presents a listing of common independence considerations along with their applicable reference to the revised *Code*. This listing is not intended to be all-inclusive, but rather to assist accountants in finding information about the most common independence considerations. In the absence of specific guidance, accountants will need to follow the guidance in the *Conceptual Framework for Independence*, as discussed beginning at paragraph 107.9.

Exhibit 1-4

Independence Rules

Independence Consideration	AICPA Ref.
Another CPA firm's participation	ET 1.220, ET 1.224
Business relationships	ET 1.265
Contractual terms	ET 1.228
Depository, brokerage, and other accounts	ET 1.255

Employee benefit plan participation	ET 1.250
Employment with attest client	ET 1.275, ET 1.277, ET 1.279
Family relationships	ET 1.270
Financial interests	ET 1.240
Gifts or entertainment	ET 1.285
Insurance products	ET 1.257
Litigation	ET 1.290
Loans, leases, and guarantees	ET 1.260
Memberships	ET 1.280
Nonattest services	ET 1.295
Reissued reports	ET 1.226
SSAEs	ET 1.297
Trusts and estates	ET 1.245

Conceptual Framework for Independence

107.9 ET 1.210.010, *Conceptual Framework for Independence*, is to be used by practitioners when making decisions on independence matters that are not explicitly addressed by the AICPA *Code of Professional Conduct*. The Conceptual Framework describes the risk-based approach to analyzing independence matters that is used by the AICPA's Professional Ethics Executive Committee (PEEC) when it develops standards. Under that approach, the practitioner's relationship with a client is evaluated to determine whether it poses an unacceptable risk to the practitioner's independence. Risk is unacceptable if the relationship would compromise (or would be perceived as compromising by a reasonable and informed third party, aware of all relevant information) the practitioner's professional judgment when rendering an attest service to the client. Under the risk-based approach, steps are taken to prevent circumstances that threaten independence from compromising the professional judgments required in the performance of an attest engagement.

107.10 The risk-based approach involves the following steps:

- Identify and evaluate threats to independence. If identified threats are not at an acceptable level, safeguards should be considered.

- Determine whether safeguards already eliminate or sufficiently mitigate identified threats and whether threats that have not yet been mitigated can be eliminated or sufficiently mitigated by safeguards. A threat has been sufficiently mitigated by safeguards if, after applying the

safeguards, it is not reasonable to expect that the threat would compromise professional judgment.

• If no safeguards are available to eliminate an unacceptable threat or reduce it to an acceptable level, independence would be considered impaired.

107.11 The Conceptual Framework provides examples of threats to independence and of safeguards that may eliminate threats or reduce them to acceptable levels. Threats to independence are defined as circumstances that could impair independence. The seven categories of threats discussed in the framework are the self-review threat, the advocacy threat, the adverse interest threat, the familiarity threat, the undue influence threat, the self-interest threat, and the management participation threat. Safeguards are controls that mitigate or eliminate threats to independence. To be effective, safeguards must eliminate the threat or reduce to an acceptable level the threat's potential to impair independence. The three broad categories of safeguards discussed in the framework (ET 1.210.010.20) are:

• Safeguards created by the profession, legislation, or regulation.

• Safeguards implemented by the attest client.

• Safeguards implemented by the firm.

107.12 In instances where threats to independence are not at an acceptable level, safeguards should be applied and the following should be documented:

• The threats identified.

• The safeguards applied to eliminate the threats or reduce them to an acceptable level.

107.13 In situations where there are no independence interpretations or rulings that address a practitioner's particular independence circumstance, ET 1.210.010.01 of the *Code* requires the practitioner to evaluate whether his or her particular independence situation would lead a reasonable person who is aware of all of the facts to conclude that the practitioner is not independent. When making that determination, practitioners employ the risk-based approach described in the Conceptual Framework for AICPA Independence Standards.

Nonattest Services and Engagements for Presentations of Prospective Financial Information

107.14 The Independence Rule at ET 1.200.001 of the AICPA *Code* (formerly Rule 101, ET 101.01) defines independence for practitioners performing attest services. The authors recommend that practitioners read the independence rule and related guidance (including the interpretations beginning at ET 1.200.005) for a thorough understanding concerning independence. [19]

107.15 A frequent concern of practitioners engaged to perform engagements on prospective presentations is meeting the independence requirements when providing both nonattest and attest services. For many attest clients, the practitioner serves as a primary business consultant and may also provide consulting, tax, or other services to them. As most practitioners are aware, PEEC issued and revised the Interpretations of Rule 101 of the former *Code* (ET 101.01) regarding the performance of nonattest services (Interpretation 101-3, *Nonattest Services*) many times. Interpretation 101-3 was located at ET 101.05 of the former *Code*. The Interpretations of the Independence Rule, *Nonattest Services*, are now located at ET 1.295 of revised *Code*. A discussion of ET 1.295 begins at paragraph 107.16.

107.16 **General Applicability of ET 1.295 (formerly Interpretation 101-3)**

Generally, if the practitioner—

a. only provides attest services for the entity, consideration of ET 1.295 is not required.

b. provides one or more nonattest services for the entity but does not provide attest services for it, consideration of ET 1.295 is not required. [20]

c. provides one or more nonattest services and one or more attest services for the entity, consideration of ET 1.295 is required. [21]

107.17 **General Requirements of ET 1.295**

The underpinning of ET 1.295 is that assuming management responsibilities impairs independence. ET 1.295.030.02 provides examples of activities that would be considered management responsibilities, and would therefore impair independence if performed by the practitioner. ET 1.295.040 describes safeguards that generally must be met to ensure that providing nonattest services is not considered to be assuming management responsibilities.

107.18 Although independence is considered to be impaired if a practitioner (or his or her firm) assumes management responsibilities, the practitioner may assist management in its fulfillment of those responsibilities. ET 1.295.030.02 provides examples of management responsibilities that would be considered to impair independence if the practitioner performed them for an attest client. ET

1.295.040.02 notes that routine activities such as providing advice and responding to client questions as part of the client relationship are not nonattest services.

107.19 Before performing nonattest services, ET 1.295.040.01 states the practitioner should be sure that the client is in a position to make an informed judgment on the results of those services and that the client understands its responsibilities to do the following:

a. Assume all management responsibilities.

b. Oversee the service by designating an individual, preferably within senior management, who possesses suitable skill, knowledge, and/or experience.

c. Evaluate the adequacy and results of the services performed.

d. Accept responsibility for the results of the services.

In cases where the client is unable or unwilling to assume all of these responsibilities, or is unwilling to carry out such responsibilities, the practitioner's performance of the nonattest services would impair independence.

107.20 ET 1.295.020.01 states that although performing an individual nonattest service might not impair independence, the cumulative effect of multiple nonattest services can increase the significance of threats to independence. [22] As discussed in ET 1.295.020.02, before agreeing to perform the services, the practitioner should evaluate whether the aggregate effect of performing multiple nonattest services results in a significant threat to independence that cannot be reduced to an acceptable level by the application of safeguards. If there are no safeguards that eliminate the threat or reduce it to an acceptable level, the member's independence would be impaired.

107.21 ET 1.295.040.01 states that the practitioner should assess and be satisfied that the individual providing oversight understands the nonattest services sufficiently to oversee them. When assessing whether a client's designated individual possesses suitable skill, knowledge, or experience, it is not intended that the client's individual possess a level of technical expertise equal to the practitioner's. The individual need only understand the nonattest services enough to be able to provide general direction for the services; understand the key issues the practitioner identifies; make any required management decisions; and evaluate the adequacy of, and accept responsibility for, the results of the practitioner's work. This may mean the practitioner will need to educate the client in order to allow him or her to assume these responsibilities.

107.22 In addition, ET 1.295.040.01 states that the understanding between the practitioner and the client should be documented in writing. To help prevent any type of misunderstanding with the client, the guidance says that, before performing the nonattest services for an attest client, the practitioner should document in writing his or her understanding with the client regarding the following:

a. Objectives of the engagement (i.e., the nonattest services).

b. Services to be performed.

c. Client's acceptance of its responsibilities.

d. Practitioner's responsibilities.

e. Any limitations of the engagement.

Although failure to obtain the required understanding would impair independence, failure to comply with the *Code's* requirement to document that understanding would not impair independence. Instead, such failure would, according to ET 1.295.050.02, be a violation of the Ethics Rule at ET 1.310.001, *Compliance with Standards*.

107.23 ET 1.295.040.01 does not specify how the written understanding is to be documented, so the practitioner has flexibility. For example, the understanding might be documented in a separate engagement letter, the workpapers, an internal memorandum, or the engagement letter obtained in conjunction with an attest engagement. Appendix 1B provides a form that can be used to document the understanding with the client about the performance of nonattest services.

107.24 The documentation requirement does not apply to nonattest services performed prior to the client becoming an attest client. The practitioner is permitted to prepare the required documentation upon acceptance of an attest engagement, provided the practitioner is able to demonstrate his or her compliance with the other general requirements during the period covered by the subject matter, including the requirement to establish an understanding with the client. See the discussion beginning at paragraph 107.29.

107.25 **Identifying Attest and Nonattest Services**

ET 1.295 applies when the practitioner provides an attest engagement for a client and also provides one or more nonattest services. In applying the guidance—

a. An *attest engagement* is defined in ET 0.400.04 as an engagement that requires independence as set forth in the SASs, the SSARSs, and the SSAEs. An examination or agreed-upon procedures engagement for a presentation of prospective financial information requires independence and therefore is an attest service.

b. A compilation engagement for a presentation of prospective financial information does not require independence. However, ET 1.297.010.01 states because the compilation report has to note if the practitioner is not independent, ET 1.295 applies to compilations of prospective presentations.

107.26 There are other types of engagements on presentations of prospective financial information that do not require independence, but, unlike compilation engagements, the practitioner is not required to report on them. (As a practical matter, the authors believe practitioners engaged by small and midsize nonpublic entities to specifically provide services other than compilations, examinations, or applications of agreed-upon procedures on presentations of prospective financial information rarely report on the engagement.) In addition, if the practitioner reports on such an engagement, there is no requirement to disclose the lack of independence. The authors believe the absence of a requirement to disclose the lack of independence causes these engagements to be treated as nonattest services rather than as attest services, and believe they would be treated accordingly.

107.27 Following the guidance in paragraphs 107.25 and 107.26—

a. Compilation, examination, or agreed-upon procedures engagements for presentations of prospective financial information are treated as attest services. Accordingly, a practitioner who is engaged only to provide additional attest services (for example, to compile, review, or audit historical financial statements) would not apply ET 1.295.

b. Other engagements for presentations of prospective financial information are nonattest services and therefore subject to ET 1.295 if the practitioner also provides attest services on historical financial information and either of the prescribed criteria discussed beginning at paragraph 107.31 are met. A practitioner performing nonattest services not related to the prospective financial information, such as bookkeeping or tax services, in addition to an attest service on the prospective financial information would also need to follow the requirements of ET 1.295.

107.28 **Is Assistance with a Presentation of Prospective Financial Information a Nonattest Service?**

In most engagements for presentations of prospective financial information for small and midsize

nonpublic entities, practitioners assist the entity in identifying key factors, developing assumptions, and preparing the presentation. ET 1.295.010.04 acknowledges that when performing attest services, practitioners often communicate with management about matters such as the selection and application of accounting standards or policies and financial statement disclosure requirements; the appropriateness of management's methods used in determining the accounting and financial reporting; adjusting journal entries prepared by the practitioner; and the form or content of the financial statements. The guidance states these communications do not constitute nonattest services and are considered a normal part of an attest engagement. The authors believe analogous guidance would apply to engagements on prospective financial information. [23]

107.29 In contrast, ET 1.295.010.06 explicitly states that financial statement preparation, cash to accrual conversions, and reconciliations are considered outside the scope of an attest engagement and are, therefore, nonattest services subject to the general requirements of ET 1.295. Consistent with the discussion in paragraph 107.28, the authors believe this provision regarding the preparation of historical financial statements would apply by analogy to services on prospective presentations. Accordingly, a practitioner performing attest services on prospective financial information will need to consider the requirements of ET 1.295 if the practitioner also prepares (assembles) that prospective information. (ET 1.295.010.06 is effective for engagements covering periods beginning on or after December 15, 2014.)

107.30 **Determining Whether ET 1.295 Applies to a Nonattest Service**

Providing advice and responding to the client's questions about accounting and financial reporting matters as part of the client-practitioner relationship are excluded from the scope of ET 1.295. For example, explaining the difference between forecasting and projecting prospective financial information to management is a service that is not subject to the requirements.

107.31 The timing of the nonattest service is critical to applying ET 1.295 The requirements apply to threats to independence during either (1) the period of the attest engagement, or (2) the period covered by the prospective financial statements. [24]

107.32 Applying the guidance in paragraph 107.31 in engagements for presentations of prospective financial information is not always clear-cut. For example, how should the requirements be evaluated —

a. For plain paper services for presentations of prospective financial information, which the authors view as nonattest services, when the practitioner also provides attest services for the entity's historical financial statements?

b. For nonattest services when the attest service for the entity is a compilation, examination, or agreed-upon procedures engagement on prospective financial information?

The discussion beginning at paragraph 107.33 considers these issues. The discussion assumes the client is the responsible party with respect to the engagement for a presentation of prospective financial information. (See the discussion beginning at paragraph 107.48 about limited exceptions to the independence requirements of ET 1.295 when the client is not the responsible party.)

107.33 The definition of *period of the professional engagement* in ET 0.400.39 says—

> The period begins when a member either signs an initial engagement letter or other agreement to perform attest services or begins to perform an attest engagement for a client, whichever is earlier. The period lasts for the entire duration of the professional relationship, which could cover many periods, and ends with the formal or informal notification, either by the member or the client, of the termination of the professional relationship or by the issuance of a report, whichever is later. Accordingly, the period does not end with the issuance of a report and recommence with the beginning of the following year's attest engagement.

107.34 ET 1.295 does not apply unless the practitioner provides a nonattest service for an attest client. Accordingly, the period of the professional engagement starts when the practitioner is engaged to provide an attest service and continues until the practitioner no longer provides an attest service. Typically, attest services for historical financial statements are recurring engagements, and therefore the period of the professional engagement is a number of years. However, attest services for presentations of prospective financial statements generally are performed as one-time engagements. For example, practitioners typically are engaged to compile a presentation of prospective financial information because of a nonrecurring requirement, such as a loan application. [25]

107.35 Because the period covered by prospective financial information is in the future, how the rule should be applied can be unclear in some cases. For example, assume the practitioner is engaged to compile a forecast for the next two years—20X5 and 20X6. If in April 20X5, after the compilation is completed, the practitioner prepares the 20X4 income tax returns, does ET 1.295 apply? Would it also apply to preparation of the 20X5 tax returns in 20X6 but not to preparation of tax returns for subsequent years since the preparation would be in years after the forecast period?

107.36 Or, assume that the client in the previous example is a start-up entity, and the compilation was requested to help negotiate financing. After the compilation is complete, the financing has been obtained, and the entity has started operations, the entity engages the practitioner to prepare the income tax returns. If the practitioner does not comply with ET 1.295 in preparing the returns during the years covered by the forecast period, is the practitioner retroactively not independent for purposes of the compilation?

107.37 As a practical matter, it is difficult to see how the preparation of income tax returns during 20X5 and 20X6 could impair the practitioner's independence in fact or in appearance with respect to the compilation of the forecast for 20X5 and 20X6. As the standard report on a compilation of a forecast says that “We have no responsibility to update this report for events and circumstances occurring after the date of our report,” it is clear that the standards do not envision notifying users of

events occurring after the report has been issued, including subsequent loss of independence.

107.38 These practice questions strongly suggest that the rule regarding the period covered by the financial statements would not be applied when the potential impairment takes place only after the engagement has been completed; that is, retroactively.

107.39 To illustrate, assume that the practitioner is engaged to compile a forecast for 20X1, 20X2, and 20X3 to help the entity negotiate financing. After operations have begun, the practitioner is engaged to provide payroll services. The authors believe ET 1.295 would not be applied to the payroll services, even though they are provided during the period covered by the forecast. However, if the practitioner is subsequently engaged to review the financial statements for 20X1, ET 1.295 would apply to determining independence with respect to the 20X1 review because of the nonattest payroll services that took place during the period covered by the review.

107.40 Additional Examples for Applying ET 1.295.

The following paragraphs discuss other situations that illustrate the application of ET 1.295 for engagements on prospective presentations.

107.41 For example, how is ET 1.295 applied when the attest service relates to historical financial statements and the nonattest service is provided on prospective financial information? Assume that the nonattest service is a plain paper service for a partial presentation of prospective financial information for 20X1 and the attest service is a review of historical financial statements for 20X1.

- If the practitioner completes the plain paper service for the 20X1 prospective financial information in January 20X1 and in November 20X1 is engaged to review the 20X1 historical financial statements, the nonattest service was provided prior to the engagement for the attest service.

- If in December 20X0 the practitioner is engaged to provide the plain paper service for the presentation of prospective financial information for 20X1 and to review the 20X1 historical financial statements, the nonattest service would be provided during the period of the attest engagement.

- However in both illustrations the plain paper service was provided during 20X1 *which is the period covered by the reviewed financial statements*. Accordingly, the requirements of ET 1.295 would need to be complied with in both circumstances; otherwise independence would be impaired for the 20X1 review.

107.42 Alternatively, how is ET 1.295 applied when the attest service relates to the prospective financial Information and the nonattest service is on something else? The following examples

illustrate the practitioner's considerations.

• Assume that the practitioner is engaged to prepare the entity's income tax returns for 20X1 and to compile a forecast for 20X2. The period of the attest engagement runs from when the practitioner is engaged to compile the forecast to when the practitioner issues the compilation report. If the practitioner prepares the entity's 20X1 income tax returns during that period, ET 1.295 applies; otherwise, it does not apply. For example, if the practitioner compiles the 20X2 forecast in 20X1 and prepares the 20X1 income tax returns in 20X2, the requirements do not apply. (The periods covered, 20X2 for the forecast and 20X1 for the tax return, do not coincide.)

• Assume that a practitioner has provided payroll services for an entity for the past two years. This year, the practitioner is also engaged to compile a forecast for the next three years. The period of the nonattest engagement is the period from when the practitioner is engaged to compile the forecast to when the practitioner issues the compilation report. Conceptually, the practitioner needs to comply with the requirements of ET 1.295 with respect to the payroll services provided during the compilation engagement. As a practical matter, although the compilation engagement covers a short period of time, the authors believe it would be best to comply with the requirements of ET 1.295.

107.43 ET 1.295.160, *Tax Services*, provides guidance on independence and tax compliance services. Preparing a tax return [26] and transmitting the tax return and related payment, either electronically or in paper form, to a taxing authority does not impair independence as long as the practitioner does not have custody or control [27] of the client's funds and the individual overseeing the tax services (a) reviews and approves the return and payment and (b) signs the return prior to transmittal, if required for the filing. Signing and filing a tax return on behalf of client management impairs independence unless the practitioner has legal authority to do so and—

• The taxing authority has prescribed procedures, allowing the taxpayer to permit the practitioner to sign and file a return on the taxpayer's behalf, that meet the standards for electronic return originators and officers outlined in IRS Form 8879, or

• An individual in client management who is authorized to sign and file the tax return provides the practitioner with a signed statement that indicates—

•• The return being filed.

•• That the individual is authorized to sign and file the return.

•• That the individual has reviewed the return, including accompanying schedules, and it is true, correct, and complete to the best of their knowledge and belief.

•• That the individual authorizes the practitioner (or another named member in the practitioner's firm) to sign and file the return on behalf of the client.

ET 1.295.160 also indicates that the practitioner's representation of the client in an administrative proceeding before a taxing authority does not impair independence providing that the practitioner obtains the client's agreement prior to committing the client to a specific resolution with the taxing authority. Independence is impaired if the practitioner represents the client in court to resolve a tax dispute.

107.44 ET 1.295.140, *Forensic Accounting*, provides guidance related to independence and performing forensic accounting services. That guidance is discussed beginning at paragraph 1701.23.

107.45 **Practical Considerations in Determining Whether to Apply ET 1.295**

As a practical matter, following the requirements of ET 1.295 helps ensure that the client clearly understands its responsibility for the presentation of prospective financial information and requires little additional work for the practitioner. Therefore, a practitioner who is unsure whether the requirements apply could easily decide to apply them.

107.46 Practitioners often choose to document the understanding required by ET 1.295 in a separate paragraph in an engagement letter. To illustrate, assume that in January 20X1 the practitioner is engaged to provide payroll services for 20X1 and to compile a forecast for 20X1. The following paragraph could be added to the engagement letter to comply with the documentation requirements at ET 1.295.040.01c:

> You agree to assume all management responsibilities for the payroll services and any other nonattest services we provide; oversee the services by designating an individual, preferably from senior management, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.

107.47 Some practitioners prefer to have the client specifically designate the individual responsible for overseeing the nonattest services. In that case, the following paragraph may be used:

> You agree to assume all management responsibilities for the payroll services and any

other nonattest services we provide; oversee the services by designating an individual, _[Name of Designated Individual, preferably from senior management]_, with suitable skill, knowledge, or experience; evaluate the adequacy and results of the services; and accept responsibility for them.

Applying ET 1.297 (formerly Interpretation 101-11) to Engagements Performed in Accordance with the SSAEs

107.48 The Independence Rule at ET 1.200.001 and its interpretations and rulings generally apply to all attest engagements. However, ET 1.297, *Independence Standards for Engagements Performed in Accordance with Statements on Standards for Attestation Engagements* (formerly ET 101.13), addresses exceptions to the independence requirements of ET 1.200.001 that could apply in engagements to report on prospective financial information. The following rules apply when performing engagements to issue reports in accordance with the SSAEs when independence is required, or when the practitioner's compilation report does not disclose a lack of independence:

• Practitioners need to be independent with respect to the responsible party(ies). [28]

• In circumstances in which the individual or entity that engages the practitioner is not the responsible party, the practitioner does not need to be independent of that individual or entity. [However, consideration should be given to the requirements of ET 1.110.010, *Conflicts of Interest*, with regard to any relationships that may exist with the individual or entity that engages the practitioner to perform these services.]

• Nonattest services that would otherwise impair independence under ET 1.295 may be provided to the responsible party when such services do not relate to the specific subject matter of the SSAE engagement, provided that the general requirements of ET 1.295 are met.

• As discussed in paragraph 107.49, additional exceptions may apply if the practitioner is engaged to perform agreed-upon procedures related to prospective financial information.

107.49 **Guidance on Independence for Agreed-upon Procedures Engagements**

ET 1.297 also describes who must be independent with respect to the responsible party(ies) in an engagement to perform agreed-upon procedures related to prospective financial information in accordance with AT 101 and AT 301. The practitioner and his or her immediate family are required to be independent with respect to the responsible party(ies) if they—

• Participate in the agreed-upon procedures engagement team,

• Directly supervise or manage the agreed-upon procedures engagement partner or partner equivalent, and

• Consult with the agreed-upon procedures engagement team regarding technical or industry-related issues specific to the agreed-upon procedures engagement.

ET 1.297.020.05 states that certain financial relationships between the practitioner's firm and the responsible party(ies) could impair independence if they are material.

Current Developments in Professional Ethics Standards

107.50 **Recently Issued Guidance**

The AICPA's PEEC has recently issued the following [29] revisions to the AICPA *Code of Professional Conduct*:

• New definition of *those charged with governance* under ET 0.400, effective April 30, 2014.

• Revised ET 1.110.010, “Conflicts of Interest for Members in Public Practice,” and adopted new ET 2.110.010, “Conflicts of Interest for Members in Business,” effective September 30, 2014.

• Revised ET 0.200.020.02-.05, “Application of the AICPA Code,” due to revisions at ET 1.110.010 and ET 2.110.010, effective September 30, 2014.

107.51 The following revisions are effective for engagements covering periods beginning on or after December 15, 2014:

• New definition added to ET 0.400.38 for *partner equivalent*.

• Revised definition in ET 0.400.12 of *covered member* due to new definition of *partner equivalent*.

• Revised the “Conceptual Framework for Independence” at ET 1.210.010 due to revised

definition of *partner equivalent*.

• Revised the guidance on “Application of the Independence Rules to Close Relatives” and “Grandfathered Employment Relationships” in ET 1.295.

• Revised guidance on “Activities Related to Attest Services” at ET 1.295.010.06 about activities that constitute nonattest services.

• Revised ET 1.295 to add guidance on “Cumulative Effect on Independence When Providing Multiple Nonattest Services” at ET 1.295.020.

• Revised ET 1.297, “Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements,” due to the new definition of *partner equivalent* (discussed at paragraph 107.48).

Performance of Nonattest Services for Clients Who File with the SEC

107.52 The SEC's independence rules for practitioners are more restrictive than those established by the AICPA. The authors recommend that practitioners with public clients, or with clients that may be considering going public, read the SEC's and PCAOB's independence rules for prospective financial information. The SEC's website is **www.sec.gov** and the PCAOB's website is **www.pcaobus.org**.

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[15] As discussed in paragraph 106.8, SSAE No. 17 permits, but does not require, the practitioner to disclose the reason(s) his or her independence is impaired in a report on compiled prospective financial statements.

[16] Practitioners performing engagements on prospective financial information for public company clients should follow the independence requirements of the PCAOB and the SEC.

[17] Section 1104 discusses the effect on independence when a practitioner is involved in actual or threatened litigation against a client.

[18] While the new conceptual frameworks in ET 1.000.010 are effective on December 15, 2015, the

conceptual framework for independence (ET 1.210.010), which was formerly in ET 100-1, was effective on December 15, 2014.

19 *PPC's Guide to GAAS* provides a comprehensive discussion of the AICPA's independence rules and related guidance.

20 However, if the practitioner anticipates being engaged to provide an attest service in the future, the practitioner should consider whether ET 1.295 will apply.

21 ET 1.297, *Independence Standards for Engagements Performed in Accordance With Statements on Standards for Attestation Engagements*, addresses modifications to the independence requirements of the Independence Rule at ET 1.200.001 in engagements performed in accordance with the SSAEs. See the discussion beginning at paragraph 107.48.

22 The guidance in ET 1.295.020 is effective for engagements covering periods beginning on or after December 15, 2014. Early implementation is not permitted.

23 This conclusion is consistent with Paragraph 5.02 of the AICPA *Guide*.

24 ET 1.295.010.03 provides a limited exception if the nonattest services were performed during the period covered by the financial statements. The practitioner's independence would not be impaired when the practitioner performed nonattest services that would otherwise have impaired independence during the period covered by the financial statements, provided that (a) the nonattest services were provided prior to accepting or beginning to perform the attest engagement, (b) the nonattest services were for a period prior to the financial statement period, and (c) the financial statements for the period to which the nonattest services relate were reviewed or audited by another firm. As a practical matter, practitioners who are initially engaged to only provide nonattest services but expect to subsequently be engaged to also provide attest services should consider structuring the engagement so that performance of the nonattest services will not impair independence for the attest services.

25 Independence applies to the client, not the service. If a practitioner's independence is impaired for an audit it would also be impaired for other attest services.

26 ET 1.295.160.02 states that a tax return includes informational tax forms.

27 The guidance states that making electronic tax payments under a taxing authority's specified criteria or remitting a check payable to the taxing authority signed by the client is not considered to be having custody or control of the client's funds.

28 See the discussion about how a responsible party is defined in the attestation standards at paragraph 103.11.

[29] More detailed information on the activities of the PEEC is available at **www.aipca.org**

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108 Rules of Other Bodies

108.1 Bodies other than the AICPA also have established rules regarding the presentation of, and practitioners' services on, prospective financial information.

IRS—Relevance of Circular 230 to Presentations of Prospective Financial Information

108.2 Treasury Department Circular No. 230, *Regulations Governing Practice before the Internal Revenue Service*, contains rules for CPAs and others representing taxpayers before the Internal Revenue Service. Its *Subpart B—Duties and Restrictions Relating to Practice Before the Internal Revenue Service* prescribes, among other things, requirements for CPAs providing written tax advice. Those requirements previously distinguished between two types of written tax advice: written advice meeting the definition of a *covered opinion* and other written advice.

108.3 In June 2014, those requirements were replaced with requirements for written advice concerning one or more federal tax matters. Those matters are generally defined as the application or interpretation of a revenue position, a provision of law impacting an obligation for federal income tax, or any other law or regulation administered by the Internal Revenue Service. The new requirements generally only address procedures the CPA should follow in developing the advice; they do not address the form of the written advice.

108.4 The authors believe a report on a presentation of financial information (either prospective or for an expired period) in accordance with professional standards (for example, the SASs, SSARS, or SSAEs) is not intended to be, and should not be, considered written advice concerning one or more federal tax matters. They believe the professional standards for engagements to provide written tax advice that are in the Statements on Standards for Tax Services are separate from the professional standards for engagements to report on presentations of prospective financial information (or presentations of financial information for expired periods). However, others may reach different conclusions. The authors recommend that a practitioner involved with a prospective presentation they believe could be considered written advice concerning one or more federal tax matters consult their legal counsel.

SEC

108.5 The Securities and Exchange Commission's general policy is to encourage registrants to disclose prospective financial information.[30] In 1979, the Commission adopted the Safe Harbor Rule for Projections, which generally provides a safe harbor for registrants who disclose prospective financial information and practitioners who report on such information, provided that the information is disclosed in good faith and has a reasonable basis. Thus, the rule is intended to encourage such disclosure by reversing the burden of proof in proceedings regarding prospective financial information. In other words, SEC rules generally place the burden of proof on the registrant and its practitioner to show that their actions were appropriate. However, the Safe Harbor Rule requires a plaintiff to prove that the information was disclosed in bad faith or without a reasonable basis. The Private Securities Litigation Reform Act of 1995 expands the Safe Harbor Rule. It provides that, in litigation under the securities acts, practitioners' statements about their clients' forward-looking information are protected if—

a. the forward-looking presentation is identified as such and is accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking presentation, or

b. the plaintiffs cannot prove that the person or entity that made the statement knew it was false or misleading.

Section 1101 gives more information about the Private Securities Litigation Reform Act of 1995.

108.6 The SEC's requirements for the form and content of prospective financial information are set forth in Regulation S-K, section 229.10(b) or, for small companies, Regulation S-B, section 228.10(d). Those sections discuss the format of the presentations, the periods to be covered, the required disclosures, the requirements to update a previously issued presentation, and the qualifications and reports of independent practitioners. The SEC generally permits registrants to substitute prospective financial statements for pro forma financial statements whenever the latter would be required (Article 11 of Regulation S-X). That alternative is not commonly used by registrants, however.

108.7 Although the SEC has not established a formal policy, in the past it has not accepted all levels of practitioners' services. For example, it has not generally accepted compilations of prospective financial statements except for what it refers to as “mathematical models” (similar to what is now called a forecast presented as a range). Accordingly, the authors recommend that practitioners check with the SEC to ascertain whether it will accept a compilation report if they are engaged to compile a forecast that is to be included in an SEC filing.

PCAOB

108.8 The Sarbanes-Oxley Act of 2002 (the Act), among other items, established the Public

Company Accounting Oversight Board (PCAOB) under the supervision of the Securities and Exchange Commission (SEC). The Act granted the PCAOB the authority to establish, or adopt auditing, quality control, ethics, independence, and other standards relating to the preparation of audit reports for auditors of public companies. The Act also authorized the SEC to recognize generally accepted accounting principles established by a private entity that meet certain criteria. In April 2003, the SEC reaffirmed the status of the FASB as the designated private-sector standard setter and formally recognized the FASB standards as generally accepted under the Act. However, the SEC retained the authority, granted under the Act, to amend, modify, repeal, or reject any such standards.

108.9 While the majority of the Sarbanes-Oxley Act directly affects only public companies and their auditors, it is important to note that there are two provisions of Sarbanes-Oxley that apply to all corporate entities. First, it is illegal for any corporate entity to punish whistleblowers or retaliate against any employee who reports suspected cases of fraud or abuse. Second, it is a crime to alter, cover up, falsify, or destroy any document that may be relevant to an official investigation.

GAO

108.10 *Government Auditing Standards, 2011 Revision*, commonly referred to as the Yellow Book, provides a framework to auditors so that their work can lead to improved government management, decision- making, oversight, and accountability. The standards also identify requirements for the scope of audit work, qualifications and independence of the auditor, and exercise of due professional care, as well as standards for planning, supervision, and reporting.

108.11 The Yellow Book defines the types of audits and services covered by the standards, including attestation engagements. According to the Yellow Book, attestation engagements can cover financial or nonfinancial subject matter and may provide different levels of assurance about the subject matter or assertion depending on the users' needs. Chapter 1 of the Yellow Book provides a number of examples of possible subject matters of attestation engagements. These examples include prospective financial statements and pro forma financial information.

108.12 Chapter 5 of the Yellow Book, titled “Standards for Attestation Engagements,” prescribes the standards and provides guidance for examination, review, and agreed-upon procedures engagements performed in accordance with generally accepted government auditing standards (GAGAS). The Yellow Book standards for attestation engagements prescribe additional standards that go beyond the requirements in the AICPA SSAEs as discussed in this guide. The Yellow Book is available on the GAO's website at **www.gao.gov/yellowbook**. Additional guidance on Yellow Book rules is provided in *PPC's Guide to Single Audits* and *PPC's Guide to Audits of Local Governments*.

108.13 Practitioners need to be aware of Interpretation No. 6 of AT 101, *Reporting on Attestation Engagements Performed in Accordance With Government Auditing Standards* (AT 9101.56). The interpretation discusses how the attestation report should be modified when a practitioner performs an attestation examination in accordance with GAGAS.

Other

108.14 Some state securities commissions have established rules regarding the types of prospective financial presentations or practitioners' services that they will require or accept. Practitioners who are engaged to provide services on prospective financial statements that will be included in a document subject to the jurisdiction of one or more state securities commissions, e.g., in offerings of limited partnership shares, should consider the individual commission's requirements. It is likely, however, that some of those regulatory bodies may change some of their requirements in light of the AICPA standards. It will, therefore, be useful to check for recent changes to regulatory requirements when performing services subject to the authority of those commissions.

108.15 Other bodies also may have requirements regarding prospective financial presentations or practitioners' reports on them. For example, a state health care authority might have authority over the form and content of an offering statement for tax-exempt revenue bonds used to finance a hospital expansion. Practitioners involved in a public offering should be aware of bodies with jurisdiction and their requirements.

International Guidance

108.16 International Standard on Assurance Engagements (ISAE) 3400, *The Examination of Prospective Financial Information*, issued by the International Auditing and Assurance Standards Board (IAASB), establishes standards and provides guidance on engagements to examine and report on prospective financial information including examination procedures for best-estimates (forecasts) and hypothetical assumptions (projections). The standard does not apply to the examination of prospective financial information expressed in general or narrative terms, such as that found in management's discussion and analysis, though many of the procedures in the standard may be suitable for such an examination. This guide does not address international standards.

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[30] Practitioners need to be aware that the SEC's independence rules differ from those established by the AICPA. See paragraph 107.52.

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109 Clarity and Convergence Projects of the AICPA

Project to Clarify and Converge the Attestation Standards

109.1 The Auditing Standards Board has undertaken a comprehensive project to clarify the attestation standards in much the same way it clarified the auditing standards, which culminated in the issuance of SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. The project is a two-phased approach:

- Revision of the general attestation standards, which are currently contained in AT 20, AT 50, AT 101, and AT 201 (referred to as the *general sections*), and

- Revision of the subject-matter specific guidance now codified in AT 301-801 (referred to as the *subject-matter sections*).

The ASB has issued three exposure drafts of the revisions to the attestation standards: an exposure draft of the general sections in July 2013, an exposure draft of three subject-matter sections (AT 301, AT 401, and AT 601) in January 2014, and an exposure draft of the subject-matter section on service organizations (AT 801) in September 2014. It is anticipated that the three exposure drafts will be combined and issued as one new attestation standard that will supersede most of the current guidance in the attestation standards. The final standard is not expected to be issued until late 2015 and is not expected to be effective before the end of 2016. Practitioners can monitor the status of the project at **www.aicpa.org/interestareas/frc/auditattest/pages/attestclarityproject.aspx**.

109.2 The following paragraphs provide an overview of the format and content of the expected final SSAE based on the status of the project as of the date of this guide.

109.3 **Structure**

The new SSAE would significantly restructure the attestation standards into the following sections:

• *Common concepts*— matters that relate to all attestation engagements. For example, this section would discuss the need for a responsible party; detail the attributes necessary for criteria to be considered suitable; and establish requirements regarding acceptance and continuance of attestation engagements, documentation, and quality control.

• *Examinations*— the performance and reporting requirements and application guidance applicable to all examination engagements that would apply in addition to the common concepts.

• *Reviews*— the performance and reporting requirements and application guidance applicable to all review engagements that would apply in addition to the common concepts.

• *Agreed-upon procedures*— the performance and reporting requirements and application guidance applicable to all agreed-upon procedures engagements that would apply in addition to the common concepts.

• *Subject-matter specific engagements*— the incremental standards for engagements now codified in AT 301-801 (excluding AT 501), such as examinations of compliance and service organization controls.

The proposed new AT structure uses an incremental approach in order to reduce redundancy. In other words, guidance in each service-related or subject-matter section would provide only the additional material relevant to the engagement. For example, guidance in common concepts would not be repeated in the examination section; instead, the examination section would provide only those additional requirements and guidance applicable to examinations. Guidance for specific services, for example examinations of financial forecasts (currently codified in AT 301), would not generally repeat guidance in the examination or common concepts section but would include only the incremental guidance relevant to the subject matter. As a result, a practitioner examining subject matter that is not the subject of a separate section, such as internal control over compliance, would refer to both the common concepts and examination sections. Similarly, a practitioner examining a financial forecast would refer to the common concepts, examination, and financial forecasts sections of the clarified SSAEs.

109.4 **Format**

Each section of the new standard (as described in paragraph 109.3) is formatted using the ASB's

clarity drafting conventions, similar to those applied in the clarified auditing standards; that is, the new attestation standard was developed using formatting techniques, such as bulleted lists, that make each section easier to read and understand. In addition, each section of the new standard will be divided into the following topics:

• *Introduction.* Includes matters such as the purpose and scope of the guidance, subject matter, effective date, and other introductory material.

• *Objectives.* Establishes objectives for each section of the standard that allow the practitioner to understand what the guidance in the section intends to achieve. The practitioner uses the objectives to determine whether additional procedures are necessary and to evaluate whether sufficient appropriate evidence has been obtained.

• *Definitions.* Provides key definitions, when relevant, in each section.

• *Requirements.* States the requirements that the practitioner is to follow to achieve the objectives unless the standard is not relevant or the requirement is conditional and the condition does not exist.

• *Application and Other Explanatory Material.* Provided separately from the requirements, the application and other explanatory material provides further guidance to the practitioner in applying or understanding the requirements. While this material does not in itself impose a requirement, practitioners should understand this guidance. How it is applied will depend on professional judgment in the circumstances considering the objectives of the specific section of the standard. The requirements topic references the related application and explanatory material. Also, when appropriate, the application and other explanatory material includes considerations relating to governmental entities or smaller, less complex entities. Finally, the application and other explanatory material paragraphs are numbered using an A- prefix and are presented following the requirements.

109.5 **Significant Changes Expected**

The July 2013 exposure draft proposes wide-ranging revisions to the general attest standards as it adopts relevant provisions of international standards and incorporates other concepts deemed necessary by the ASB. The changes proposed to the subject-matter sections will serve principally to clarify the existing guidance and conform it to the format of the proposed general standards. The following discussion provides an overview of some of the most significant changes expected as a

result of the ASB project. (Practitioners should refer to the final standard when issued for the actual changes. Future editions of this guide will be updated for the standards when finalized.)

109.6 Written Assertions.

The practitioner would be required to obtain a written assertion from the responsible party in all examination and review engagements. (The trend of thinking at the ASB as this guide was completed is that the practitioner also would be required to request written assertions for agreed-upon procedures engagements, but this matter is still being deliberated.) The current standards state that a practitioner should *ordinarily* obtain a written assertion from the responsible party in an examination or review engagement. When the engaging party is not the responsible party, the practitioner currently can perform the engagement without obtaining a written assertion but is required to restrict the use of the report. That report-restriction alternative would not be permitted for examinations and reviews under the proposed standards; a written assertion would have to be obtained in all cases.

109.7 Representation Letters.

The proposed standards would require representation letters for all examinations and reviews. Currently, AT 101 and AT 201 do not require representation letters, but AT 101 suggests that one be requested. (The trend of thinking at the ASB as this guide was completed is that a similar requirement also would apply to agreed-upon procedures engagements, but this matter is still being deliberated.) Representation letters are generally required by the current attestation standards that provide specific subject matter guidance (AT 301-801).

109.8 Although the practitioner would generally be required to obtain a representation letter from the responsible party, it is expected that the final SSAE would allow an exception to this rule when the responsible party is not the client. In that case, if the practitioner obtained satisfactory oral responses from the responsible party to the matters that would have been included in the representation letter, the practitioner could issue an examination or review report, but use of the report would have to be restricted to the client.

109.9 When the client is not the responsible party, the practitioner would also be required to obtain a separate representation letter from the client in all examination and review engagements. Although such a letter is suggested in the current standards, it is not required.

109.10 Incorporation of Auditing Concepts.

Because the ASB believes that an examination under the attestation standards is conceptually equivalent to an audit under GAAS, the proposed standards adopt several requirements previously found only in GAAS. The most significant is a requirement to apply risk-assessment procedures in an attest examination, which will establish a scope of testing that is responsive to the risks of material misstatement. The risk assessment would include an understanding of internal control over the subject matter and an assessment of risks of material misstatement of the subject matter.

109.11 The proposed standards for examination engagements also would create requirements

similar to those in the auditing standards in the following areas (although the requirements would be less detailed than the analogous auditing standards):

- Materiality
- Tests of controls
- Analytical procedures
- Estimates
- Sampling
- Fraud
- Internal auditors

Those proposed requirements would not apply to review engagements. Based on the ASB's logic that attestation engagements share many of the same attributes as their counterparts for services on historical financial statements, the required understanding and procedures in a review under the attestation standards would generally mirror those in a review performed in accordance with the SSARS.

109.12 **Proposed Changes to Standards for Engagements on Prospective Presentations**

It would be premature to predict the precise content of the new standards that would govern services on prospective financial information; however, the ASB has made some preliminary decisions as of the date of this guide. The authors anticipate the clarified SSAEs would change the authoritative literature for engagements on prospective presentations as follows:

- *Compilations.* Guidance for compilation services would be removed from the SSAEs because those standards are intended to apply only to examination, review, and agreed-upon procedures engagements. AT 301 covers compilations because of a historical anomaly—it was originally issued before the attestation standards were established. Accordingly, the AICPA's ARSC has

undertaken a project to issue a SSARS that would establish standards for compilations of prospective financial information. It is likely that the new SSARS would conform the trigger that requires the practitioner to compile a prospective presentation to the requirements for historical financial statements. (See the discussion beginning at paragraph 109.14.)

• *Examinations.* The ASB did not undertake a comprehensive re-examination of the existing standards as part of the clarity project. To reduce redundancy and increase clarity, requirements applicable to all examination engagements (for example, documentation and engagement letter requirements) will not be repeated in the clarified version of AT 301. The most substantive revisions involve examination reports: the report wording would be more descriptive and the practitioner's opinion would be expanded to also state that the assumptions are suitably supported.

• *Agreed-upon Procedures.* The exposure draft proposes format changes to the standard and minor changes to report language that mirror the proposed changes to AT 201.

• *Definitions and Presentation Guidelines.* The AICPA guide, rather than the guidance presently in AT 301, establishes the definitions of forecast, projection, and full and partial presentations; the appropriateness of the different types of presentations for general and limited use, and the disclosures required for presentations of prospective financial information. AT 301 merely quotes that guidance. Accordingly, the revision of AT 301 would not affect those matters.

109.13 **Other Proposed Changes to the Attestation Standards**

The following summarizes the proposed revisions to the other subject-matter sections in the attestation standards:

• *Provide Criteria for AT 401 Engagements.* The new standards would describe the criteria to be used in an examination or review of pro forma financial information; such criteria are not explicit in current AT 401. Based on the latest discussion by the ASB, the proposed definition of *criteria* is expected to consist of what the responsible party claims to have done in developing the pro forma adjustments based on the proposed transaction or event. Those criteria would be disclosed in the presentation.

• *Migration of AT 501 to the Auditing Standards.* Because AT 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements*, applies only in conjunction with a financial statement audit, the ASB concluded that

it integrates more naturally in the auditing literature. Under a separate project, in September 2014 the ASB issued an exposure draft of a proposed new Statement on Auditing Standards to provide guidance on integrated audits.

• *AT 701 to Retain Current Guidance.* The ASB does not intend to revise AT 701, *Management's Discussion and Analysis*, as part of the current clarity project because practitioners rarely perform these engagements. The ASB intends to retain AT 701 in its current form and decide on its disposition in the future.

Project to Clarify the Compilation and Review Standards

109.14 In May 2010, the Accounting and Review Services Committee (ARSC) approved a project to clarify the compilation and review standards using the drafting conventions used by the ASB in its project to clarify and converge the auditing standards. The project culminated with the issuance of SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, in October 2014. SSARS No. 21 is effective for periods ending on or after December 15, 2015, and early implementation is permitted. [31] SSARS No. 21 is comprised of four sections [32] —

• AR-C 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services*.

• AR-C 70, *Preparation of Financial Statements*.

• AR-C 80, *Compilation Engagements*.

• AR-C 90, *Review of Financial Statements*.

109.15 SSARS No 21 (AR-C 70) introduced a new level of service-the financial preparation service. AR-C 70 allows practitioners to prepare financial statements that may be given to third parties and not report on those financial statements if they are engaged to do so. It states that there is a difference between being *engaged to prepare financial statements* and merely *assisting in preparing financial statements*. Judgment is required to determine whether the practitioner has been engaged to prepare financial statements.

109.16 If the practitioner determines that he or she has been engaged to prepare financial

statements, the practitioner is required to follow the performance requirements in AR-C 70.AR-C 70's requirements address the following:

• Accepting or continuing the engagement;

• Agreeing with management on the terms of the engagement;

• Understanding the client's applicable financial reporting framework (cash, tax, GAAP, etc.);

• Preparing the financial statements in accordance with the applicable financial reporting framework, with specific requirements related to financial statements that omit substantially all disclosures and financial statements prepared using a special-purpose framework;

• Preparing sufficient documentation for the engagement to provide a clear understanding of the practitioner's work; and

• Including a statement, commonly referred to as a legend, on each page of the financial statements that no assurance is being provided. (If the financial statements do not include a legend indicating no assurance is provided, the practitioner should either perform a compilation engagement or issue a disclaimer that makes it clear that the practitioner is providing no assurance.)

109.17 The issuance of SSARS No. 21 will also result in a number of significant changes to the standards for compilation engagements. Some of the important changes in AR-C 80 include—

• Compilations become *engagement* driven instead of *submission* driven. After SSARS No. 21 becomes effective practitioners will only perform compilations when they are engaged to do so.

• Practitioners will no longer have the option to perform a management-use-only compilation engagement in which no report is issued.

• An engagement letter that is signed by both the practitioner and management or those charged with governance is required.

• The standard compilation report is shortened significantly, consisting of only one paragraph, and it must include the city and state in which the practitioner practices.

109.18 Because early implementation of SSARS No. 21 is permitted, this guide provides limited guidance for the new requirements of SSARS No. 21, primarily in the context of engagements on prospective information that also include services on comparative historical financial information.

• Section 402 discusses how SSARS No. 21 affects engagements when both prospective and historical statements are intended for internal use and describes the new standards in AR-C 70 for financial statement preparation services.

•• Appendix 4A includes two new engagement letters that may be used for engagements that combine assembly services on prospective presentations with services on historical statements.

•• Appendix 4D includes two new illustrative report examples for reporting on engagements that combine assembly services on prospective presentations with compilation of historical statements.

• Section 803 discusses the new performance and reporting standards for compilations in AR-C 80 and how they will affect comparative presentations of prospective and historical information.

•• Appendix 8E includes seven new illustrative report examples for reporting on compilation engagements on prospective statements that are presented with comparative historical statements.

109.19 More detailed information on the new AR-C 70 preparation service can be found in *PPC's Guide to SSARS Preparation Engagements*. In addition, the 2015 edition of *PPC's Guide to Compilation and Review Engagements* will be available early summer 2015 and will fully incorporate the new requirements of SSARS No. 21 with numerous practice aids and illustrative report examples to help practitioners implement the new standards for their engagements on historical financial

information. These guides can be ordered by calling (800) 431-9025 or via our website at **tax.thomsonreuters.com**.

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[31] SSARS No. 21 supersedes all of the existing SSARS other than SSARS No. 14, *Compilation of Pro Forma Financial Information*. Pro forma financial information will be addressed by ARSC along with the assembly and compilation of prospective financial information, during 2015. As discussed in paragraph 109.12, the ASB's project to clarify the attestation standards also contemplates migrating the standards for compilations of prospective financial information from the attestation standards to the SSARS. The status of the ARSC's clarity project can be monitored at **www.aicpa.org/interestareas/frc/review/pages/arscclarityproject.aspx**. Future editions of this guide will update the status of this project.

[32] The new standards have AR-C references to differentiate them from the extant literature. This is the same method that was used to differentiate between the old auditing standards (AU references) and clarified auditing standards (AU-C references).

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110 Considering the Effects of Economic Uncertainty

110.1 Significant economic uncertainty creates special considerations for the preparer of prospective financial information and the practitioner performing services related to such information. Appendix 1C addresses those special considerations.

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