

Agenda Item 1



Proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016*

Objective of Agenda Item

To discuss issues raised in the comment letters received on the proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016* and to consider proposed revisions to the draft SSARSs as a result of the comments received and consider voting to issue as final SSARSs.

Background

On December 8, 2015 the ARSC issued an exposure draft which contained three proposed SSARSs – *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016*.

Comments on the proposed SSARSs were due by May 6, 2016. Eight comment letters were received.

Issues For Discussion With the ARSC

Written Representations in a Compilation of Prospective Financial Information

The exposure draft of the proposed SSARS, *Compilation of Financial Statements* does not include a requirement for the accountant to obtain written representations. This contrasts with extant AT section 301, *Financial Forecasts and Projections* which includes such a requirement.

The ARSC determined to not include a requirement for the accountant to obtain written representations because such a requirement would be inconsistent with the requirements for a compilation of historical financial statements – that is an engagement in which the accountant is not required to obtain any assurance. Additionally, the ARSC believed that an important element of the written representations required by extant AT section 301 is management's acknowledgment of its responsibility for the significant assumptions. The ARSC believed that the requirement in the proposed SSARS for the accountant to obtain an engagement letter or other suitable form of written agreement between the parties that includes, among other things, the responsible party's agreement that the prospective financial information will include disclosure of the significant assumptions provides, in substance, the same acknowledgement as required by extant AT section 301.

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The argument for requiring the accountant to obtain written representations in a compilation of prospective financial statements is that the responsible party's assumptions in an engagement in which the subject matter is prospective financial information provide the sole basis for the presentation (as sharply contrasted with the existence of books and records in an engagement in which the subject matter is historical financial statements). Only the responsible party is in a position to know whether the assumptions are appropriate and faithfully represent the manner in which management intends to operate the entity's business going forward. Additionally, accountants who perform these engagements have always obtained such written representations and members of the SSARs Prospective Information Task Force (who all strongly recommended that such requirements be retained in the proposed standard) have expressed their intentions to continue to do so, as have ARSC member firms. In light of the expected continuation of this procedure as an expected best practice vs. a SSARs requirement, a question is whether the public interest would be appropriately served by not retaining the extant requirement. Also, a compilation of prospective financial information cannot be perfectly analogized to a compilation of historical financial statements because, unlike historical financial statements, an accountant is precluded from performing a review of prospective financial information. This preclusion is particularly important and relevant relative to this issue because in practice, as a practical matter due to time, economic and other constraints, an examination service is rarely a realistic option as an alternative to parties desiring something more than a compilation service.

As part of the exposure draft, the ARSC included a specific request for comment asking respondents to respond specifically as to whether they agree with the decision to not require written representations in a compilation of prospective financial information and provide reasoning.

Six of the eight respondents directly responded to the request for comment. Four of the respondents (Texas Society of CPAs – Professional Standards Committee; RSM US LLP; Grant Thornton LLP; and AICPA Technical Issues Committee) are supportive of the decision to not include a requirement for the accountant to obtain written representations in a compilation of prospective financial information while two of the respondents (New Jersey Society of CPAs – Accounting and Auditing Standards Interest Group and CAMICO) are opposed. See agenda item 1C for the details of the respondents' comments.

A primary concern of those that believe that a representation letter should be required in a compilation of prospective financial information is that the assumptions often change during the course of the engagement and that obtaining management's acknowledgment of its responsibility for the assumptions as part of the engagement letter is insufficient. A solution to this concern may be to include a requirement that reads:

X. The underlying assumptions may evolve or be modified over the course of the engagement. In such circumstances, to document the responsible party's

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acknowledgment and understanding of its responsibility for the underlying assumptions the accountant should either

- a. amend or include an addendum to the engagement letter or other suitable form of written agreement, as applicable, or
- b. obtain a representation letter that includes the responsibility party's acknowledgment for the modified underlying assumptions.

Then, instead of either not requiring or requiring a representation letter in a compilation of prospective financial information, the ARSC could consider a requirement to *consider* obtaining a representation letter. Such a requirement may read as follows:

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Written Representations	Written Representations (Ref: par. X.1)
<p>X.1 The accountant is not required to request or obtain written representations from the responsible party however, the accountant may find a representation letter to be a useful and practical means of obtaining representations from the responsible party. (Ref: par. X.A1-X.A3)</p>	<p>X.A1 The need for a representation letter may depend on the nature of the engagement for example, an engagement in which the underlying assumptions change during the course of the engagement.</p> <p>X.A2 Examples of matters that may appear in a representation letter from the responsible party for a financial forecast include the following:</p> <ul style="list-style-type: none"> • A statement that the financial forecast presents the responsible party’s assumptions and, to the best of its knowledge and belief, the entity’s expected financial position, results of operations, and cash flows (or equivalent for special purpose frameworks) for the period in accordance with the applicable financial reporting framework expected to be used during the forecast period, which are consistent with the principles the entity uses in preparing its historical financial statements. • A statement that the financial forecast reflects the responsible party’s judgment based on present circumstances of the expected conditions and the responsible party’s expected course of action. • A statement that the financial forecast is presented in accordance with the guidelines for presentation of a financial forecast established by the AICPA. • A statement that the responsible party believes that the assumptions underlying the forecast are reasonable and

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appropriate.

- A statement that the responsible party has made available to the accountant all significant information that they believe is relevant to the forecast.
- A statement that, to the best of the responsible party's knowledge and belief, the documents and records supporting the assumptions are appropriate.
- Other matters as the practitioner deems appropriate.

X.A3 Examples of matters that may appear in a representation letter from the responsible party for a financial projection include the following:

- A statement that the financial projection presents the responsible party's assumptions and, to the best of its knowledge and belief, the entity's expected financial position, results of operations, and cash flows (or equivalent for special purpose frameworks) for the projection period assuming [*describe the hypothetical assumptions*].
- A statement that the accounting principles used in the financial projection are in accordance with the applicable financial reporting framework expected to be used by the entity during the projection period, which are consistent with the principles the entity uses in preparing its historical financial statements.
- A statement that the financial projection reflects the responsible party's judgment, based on present

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circumstances, of the expected conditions and the responsible party's expected course of action assuming [*describe hypothetical assumptions*].

- A statement that the financial projection is presented in accordance with the guidelines for presentation of a financial projection established by the AICPA.
- A statement that the responsible party believes that the assumptions underlying the projection are reasonable and appropriate assuming [*describe hypothetical assumptions*].
- A statement that the responsible party has made available to the accountant all significant information that they believe is relevant to the financial projection.
- A statement that, to the best of the responsible party's knowledge and belief, the documents and records supporting the assumptions are appropriate.
- A statement that the responsible party intends to use the projection only for [*describe intended limited use*].
- Other matters as the practitioner deems appropriate.

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Action Requested of the ARSC

The ARSC is asked to consider the specific comments received as to whether respondents agree with the decision to not require written representations in a compilation of prospective financial information. The ARSC is also asked to consider whether the requirements in the proposed SSARS, *Compilation of Prospective Financial Information* are sufficient in this regard or if the proposed SSARS should be revised to either require the accountant to obtain written representations or to require the accountant to consider obtaining written representations.

Suitable Criteria

Paragraph .A1 of the exposure draft of the proposed SSARS, *Compilation of Prospective Financial Information* reads as follows:

- .A1 The guide provides suitable criteria for the preparation and presentation of prospective financial information. While this section refers to the guide, the accountant is not prohibited from performing a compilation engagement on prospective financial information prepared and presented in accordance with other suitable criteria. If other suitable criteria are used, this section should be adapted as necessary.

The draft of the proposed standard included as agenda item 1A moves the guidance to paragraph 3.

When considering the guidance prior to the issuance of the exposure draft the ARSC members could not immediately identify any sources of suitable criteria for the preparation and presentation of PFI other than the AICPA Guide *Prospective Financial Information*. However, the ARSC did not want to preclude an accountant from performing a compilation of PFI if other suitable criteria was developed.

The guidance in the proposed SSARS is not included in the clarified attestation standards for examinations of prospective financial information. Additionally, unlike the clarified attestation standards, the proposed SSARS does not provide any detail that an accountant can use to determine whether criteria is suitable. The relevant application guidance from AT-C section 105, *Concepts Common to All Attestation Engagements* is included as an appendix to this discussion memorandum.

A further issue is how the section would be “adapted as necessary”. Much of the guidance in the proposed SSARS is based on preparation and presentation concepts in the guide that may not exist in the alternative criteria. For example, the concepts of expectations, hypothetical assumptions, and general and limited use are in the presentation guidelines included in the guide but may not be included in the “other criteria.”

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Action Requested of the ARSC

The ARSC is asked whether it continues to support the inclusion of guidance stating that an accountant may perform a compilation of prospective financial information prepared and presented in accordance with criteria other than that contained within the guide. If so, the ARSC is asked whether guidance with respect to determining whether criteria is suitable should be included in the SSARS.

Overall Action Requested of the ARSC

The ARSC is asked to consider the issues raised in the comment letters received on the exposure draft of the proposed SSARSs and whether any revisions to the draft standard should be made. The ARSC is also asked to consider voting to issue the proposed standards as final SSARSs.

Agenda Items Presented:

- Agenda item 1A Draft of the proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016* – redline to show changes from exposure draft
- Agenda item 1B Exposure draft of the proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus - 2016*
- Agenda item 1C Summary of comment letters received on the exposure draft of the proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016*

All comment letters received on the exposure draft of the proposed SSARSs *Compilation of Prospective Financial Information, Compilation of Pro Forma Financial Information, and Omnibus – 2016* are available at

<http://www.aicpa.org/Research/ExposureDrafts/CompilationReview/Pages/LoC-on-ED-of-Proposed-SSARSs-PFI-Pro-Forma-and-Omnibus.aspx>.

Appendix

Excerpt from AT-C Section 105, *Concepts Common to All Attestation Engagements Regarding “Suitable Criteria”*

Suitable and Available Criteria (Ref: par. .25b(ii))

.A42 Suitable criteria exhibit all of the following characteristics:

- *Relevance.* Criteria are relevant to the subject matter.
- *Objectivity.* Criteria are free from bias.
- *Measurability.* Criteria permit reasonably consistent measurements, qualitative or quantitative, of subject matter.
- *Completeness.* Criteria are complete when subject matter prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter.

The relative importance of each characteristic to a particular engagement is a matter of professional judgment.

.A43 Criteria can be developed in a variety of ways, for example, they may be

- embodied in laws or regulations.
- issued by authorized or recognized bodies of experts that follow a transparent due process.
- developed collectively by a group that does not follow a transparent due process.
- published in scholarly journals or books.
- developed for sale on a proprietary basis.
- specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter or assertion in the particular circumstances of the engagement.

How criteria are developed may affect the work that the practitioner carries out to assess their suitability.

.A44 Criteria that are established or developed by groups composed of experts that follow due process procedures, including exposure of the proposed criteria for public comment, are ordinarily considered suitable. Criteria promulgated by a body designated by the Council of the AICPA under the AICPA Code of Professional Conduct are, by definition, considered to be suitable.

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.A45 In some cases, laws or regulations prescribe the criteria to be used for the engagement. In the absence of indications to the contrary, such criteria are presumed to be suitable.

.A46 Criteria may be established or developed by the engaging party, the responsible party, industry associations, or other groups that do not follow due process procedures or do not as clearly represent the public interest. The practitioner's determination of whether such criteria are suitable is based on the characteristics described in paragraph .A42.

.A47 Regardless of who establishes or develops the criteria, the responsible party or the engaging party is responsible for selecting the criteria, and the engaging party is responsible for determining that such criteria are appropriate for its purposes.

.A48 Some criteria may be suitable for only a limited number of parties who either participated in their establishment or can be presumed to have an adequate understanding of the criteria. For example, criteria set forth in a lease agreement for override payments may be suitable only for reporting to the parties to the agreement because of the likelihood that such criteria would be misunderstood or misinterpreted by parties other than those who have specifically agreed to the criteria. Such criteria can be agreed upon directly by the parties or through a designated representative.

.A49 Even when established criteria exist for a subject matter, specific users may agree to other criteria for their specific purposes. For example, various frameworks can be used as established criteria for evaluating the effectiveness of internal control. Specific users may, however, develop a more detailed set of criteria that meet their specific information needs.

.A50 If criteria are specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter or assertion in the particular circumstances of the engagement, they are not suitable if they result in subject matter, an assertion, or a practitioner's report that is misleading to the intended users. It is desirable for the intended users or the engaging party to acknowledge that specifically developed criteria are suitable for the intended users' purposes. The absence of such an acknowledgement may affect what is to be done to assess the suitability of the criteria and the information provided about the criteria in the report.

.A51 Criteria need to be available to the intended users to allow them to understand how the subject matter has been measured or evaluated. Criteria are made available to the intended users in one or more of the following ways:

- a. Publicly
- b. Through inclusion in a clear manner in the presentation of the subject matter
- c. Through inclusion in a clear manner in the practitioner's report
- d. By general understanding, for example, the criterion for measuring time in hours and minutes
- e. Available only to specified parties, for example, terms of a contract or criteria issued by an industry association that are available only to those in the industry

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.A52 When criteria are available only to specified parties, sections 205 and 210 require a statement restricting the use of the practitioner's report.