



## Agenda Item 1B

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# EXPOSURE DRAFT

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## PROPOSED STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES

### *Revisions to Statement on Standards for Accounting and Review Services No. 21, Statements on Standards for Accounting and Review Services: Clarification and Recodification (as amended)*

*Revises the following sections of Statement on Standards for Accounting and Review Services  
(SSARS) No. 21 (as amended):*

- *AR-C section 60, General Principles for Engagements  
Performed in Accordance With Statements on Standards for  
Accounting and Review Services*
- [\*AR-C section 70, Preparation of Financial Statements\*](#)
- [\*AR-C section 80, Compilation Engagements\*](#)
- *AR-C section 90, Review of Financial Statements*

[January XX, 2019](#)

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**Comments are requested by April 19, 2019**

Prepared by the AICPA Accounting and Review Services Committee for comment from persons interested in review and reporting issues. Comments should be addressed to Mike Glynn at [mike.glynn@aicpa-cima.com](mailto:mike.glynn@aicpa-cima.com).

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## Explanatory Memorandum

### Introduction

Statements on Standards for Accounting and Review Services (SSARSs) represent the standards that accountants in public practice are required to follow when performing reviews, compilations, and engagements to prepare financial statements. AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services* provides the requirements and associated application guidance that is applicable to all engagements performed in accordance with SSARSs. The requirements and associated application guidance specific to [preparation, compilation and review engagements](#) are provided in [AR-C section 70, Preparation of Financial Statements](#); [80, Compilation Engagements](#); and [AR-C section 90, Reviews of Financial Statements](#), [respectively](#).

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[Paragraph .06 of extant AR-C section 70 states that the objective of the accountant in a preparation engagement is to prepare financial statements pursuant to a specified financial reporting framework.](#)

[Paragraph .04 of extant AR-C section 80 states that the objective of the accountant in a compilation engagement is to apply accounting and financial reporting expertise to assist management in the presentation of financial statements and report in accordance with AR-C section 80 without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.](#)

Paragraph .04 of extant AR-C section 90 states that the objective of an accountant when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, primarily through the performance of inquiry and analytical procedures.

This memorandum provides background regarding why the Accounting and Review Services Committee (ARSC) is issuing this proposed SSARS, *Revisions to Statement on Standards for Accounting and Review Services No. 21, Clarification and Recodification*, which would amend AR-C sections 60, [70](#), [80](#), and 90.<sup>1</sup>

The most significant aspects of this proposed SSARS are explained in the section, “Changes From Existing Standards.”

### Background

The ARSC issued SSARS No. 21 in October 2014. In developing SSARS No. 21, the ARSC used AU-C section 930, *Interim Financial Information* (AICPA, Professional Standards), as a base. AU-C section 930 was clarified using International Standard on Review Engagements (ISRE)

<sup>1</sup> All AR-C sections can be found in AICPA *Professional Standards*.

2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*, as a base, and there are no substantive differences between AU-C section 930 and ISRE 2410. ARSC had determined that it was more appropriate to converge with the corresponding limited assurance engagement guidance in the American auditing literature than with ISRE 2400 (Revised), *Engagements to Review Historical Financial Statements*.

Subsequent to the issuance of SSARS No. 21, the ARSC issued SSARS Nos. 22-24 to further clarify the requirements and guidance for preparation, compilation, and review engagements. In developing and issuing SSARS No. 24, *Omnibus Statement on Standards for Accounting and Review Services – 2018* in May 2018, which included requirements and guidance with respect to international reporting issues, the ARSC determined that further convergence with ISRE 2400 (Revised) was appropriate and in the public interest. The ARSC believes that it is important for the SSARSs literature to be as closely converged with ISRE 2400 (Revised) so as to facilitate the accountant's ability to perform and report on engagements in accordance with both sets of standards. In addition, the ARSC believes that unnecessary differences between the standards will result in confusion as to whether an engagement performed in accordance with one set of standards results in the accountant obtaining a different level of assurance than that which would have been obtained had the engagement been performed in accordance with the other set of standards.

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In addition, the international literature includes the concept of a *compliance framework* when a framework requires compliance with the requirements of the framework but does not

- a. Acknowledge explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.
- b. Acknowledge explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.

whereas the SSARSs (and U.S. auditing standards) are premised on all general purpose and special purpose frameworks being *fair presentation frameworks*. The proposed standard challenges that premise and introduces the concept of a *compliance framework* to the SSARSs. The Auditing Standards Board is proposing similar revisions to the auditing literature.

## Changes From Existing Standards

### Proposed Revisions that Apply to Review Engagements Only

The following is a summary of the proposed changes to extant AR-C section 90 that the ARSC believes would be the most significant. The proposed revisions to AR-C section 60 are not considered significant.

*Issue #1 – Requirement for the accountant to plan and perform the review with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated*

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Traditionally, AR-C section 90 has not included an explicit requirement for the accountant to plan and perform the review with professional skepticism. The ARSC believes that the effectiveness of the accountant's procedures and the overall quality of the review engagement is dependent on the accountant planning and performing review procedures consistent with the concept of professional skepticism.

**Request for Comment 1**

Please provide your views on the proposed [explicit](#) requirement for the accountant to plan and perform the review with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. Do you believe that the proposed application guidance is helpful and sufficient for accountants in applying the proposed requirement?

*Issue #2 – Requirement for the accountant to determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures*

While extant AR-C section 90 does not include an explicit requirement for the accountant to determine materiality and apply such materiality in designing procedures and evaluating results, as stated in paragraph .04 of extant AR-C section 90, the accountant's objective when performing a review of financial statements is to obtain limited assurance as a basis for reporting whether the accountant is aware of any *material* modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework. As such, without a determination of materiality, the accountant is unable to meet the objective of the review engagement. For example, the accountant is required to consider materiality when,

- in accordance with paragraph .17 of extant AR-C section 90, designing and performing analytical procedures and making inquiries and performing other procedures, as appropriate, to obtain limited assurance as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework.
- in accordance with paragraph .28 of extant AR-C section 90, evaluating whether uncorrected misstatements, including inadequate disclosure, identified by the practitioner in performing the review procedures or brought to the accountant's attention during the performance of the review are, individually and in the aggregate, material to the financial statements in order to determine whether any modifications should be made to the financial statements in order for them to be in accordance with the applicable financial reporting framework.

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**Request for Comment 2**

Please provide your views on the proposed [explicit](#) requirement for the accountant to determine materiality for the financial statements as a whole, and apply this materiality in designing the procedures and in evaluating the results obtained from those procedures. Do you believe that the proposed application guidance is helpful and sufficient for accountants in applying the proposed requirement?

Issue #3 – Requirement for the accountant in obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, to design and perform analytical procedures and inquiries to address all material items in the financial statements, including disclosures

Extant paragraph .18 of AR-C section 90 requires the accountant to focus analytical procedures and inquiries in those areas where the accountant believes that there are increased risks of material misstatements. The proposed requirement would require the accountant, in addition to those areas where the accountant believes that there are increased risks of material misstatements, to focus procedures on all material items in the financial statements.

**Request for Comment 3**

Please provide your views on the proposed requirement for the accountant, in obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statements as a whole, to design and perform analytical procedures and inquiries to address all material items in the financial statements, including disclosures.

Issue #4 – Requirement for the accountant to inquire of members of management who have responsibility for financial and accounting matters concerning the financial statements about:

- a. material commitments, contractual obligations or contingencies that have affected or may affect the entity's financial statements, including disclosures.
- b. material non-monetary transactions or transactions for no consideration in the financial reporting period under consideration.

The proposed required inquiries would be in addition to the inquiries required by paragraph .22 of extant AR-C section 90.

**Request for Comment 4**

Please provide your views on the proposed additional required inquiries of members of management who have responsibility for financial and accounting matters concerning the financial statements.

Issue #5 – Requirement for the accountant, during the review, to remain alert for arrangements or information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed to the accountant. If the accountant identifies significant transactions outside the entity's normal course of business in the course of performing the review, the accountant should inquire of management about:

- (a) The nature of those transactions; and
- (b) Whether related parties could be involved

**Request for Comment 5**

Please provide your views on the proposed additional required procedures with respect to the accountant's consideration of related parties in a review of financial statements.

Issue #6 – Requirement for the accountant to express an adverse conclusion when he or she determines or is otherwise aware, that the financial statements are materially misstated and the effects of the matter(s) are both material and pervasive to the financial statements.

The ARSC questioned whether the prohibition in extant AR-C section 90 on the accountant modifying the standard report to include a statement that the financial statements are not in accordance with the applicable financial reporting framework (i.e., an adverse conclusion) remains appropriate [when the financial statements are materially misstated and the effects of the matter\(s\) are both material and pervasive to the financial statements](#). ISRE 2400 (Revised) permits the issuance of an adverse conclusion.

The ARSC concluded that it was not in the public interest to prohibit the expression of an adverse conclusion when the accountant is aware that the financial statements are materially and pervasively misstated. [While](#) the accountant may determine to withdraw from the engagement, [if so](#), users of the financial statements may not [then](#) be made aware of such misstatements. Further, the ARSC considered the situation in which an accountant is engaged to perform a review in accordance with both SSARs and ISRE 2400 (Revised) and has identified a misstatement that is material and pervasive to the financial statements. While extant SSARs prohibit the issuance of an adverse conclusion, ISRE 2400 (Revised) would require the issuance of such a conclusion. As such, [in reporting](#), the accountant would not be able to adhere to both sets of standards.

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**Request for Comment 6**

Please provide your views on the [proposal to permit](#) the accountant to express an adverse conclusion when he or she determines or is otherwise aware, that the financial statements are materially misstated and the effects of the matter(s) are both material and pervasive to the financial statements.

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Issue #7 – Requirement for the accountant to document information that the accountant identified that is inconsistent with the accountant's findings regarding significant matters affecting the financial statements and how the inconsistency was addressed.

The proposed documentation requirement would be in addition to the requirement in paragraph .94c of extant AR-C section 90 that the accountant prepare review documentation that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand significant findings or issues arising during the review, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

**Request for Comment 7**

Please provide your views on the proposed additional required documentation in a review of financial statements.

[Proposed Revisions that Apply to Compilation and Review Engagements](#)

[Issue #8 – The concept of a compliance framework](#)

[Financial reporting framework](#) is defined in SSARs as follows<sup>2</sup>:

**[Financial reporting framework.](#)** [A set of criteria used to determine measurement, recognition, presentation, and disclosure of all material items appearing in the financial statements \(for example, accounting principles generally accepted in the United States of America \[U.S. GAAP\], International Financial Reporting Standards promulgated by the International Accounting Standards Board, or a special purpose framework\).](#)

[The term fair presentation framework refers to a financial reporting framework that requires compliance with the requirements of the framework and does one of the following:](#)

- [a. Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework.](#)
- [b. Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in rare circumstances.](#)

[A financial reporting framework that requires compliance with the requirements of the framework but does not contain the acknowledgment in \(a\) or \(b\) is not a fair presentation framework.](#)

Further, the term [special purpose framework](#) is defined in SSARs as follows<sup>3</sup>:

**[Special purpose framework.](#)** [A financial reporting framework other than GAAP that is one of the following bases of accounting:](#)

- [a. \*\*Cash basis.\*\* A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support \(for example, recording depreciation on fixed assets\).](#)
- [b. \*\*Tax basis.\*\* A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements.](#)
- [c. \*\*Regulatory basis.\*\* A basis of accounting that the entity uses to comply with the requirements or financial reporting provisions of a regulatory agency to whose jurisdiction the entity is subject \(for example, a basis of accounting that insurance companies use pursuant to the accounting practices prescribed or permitted by a state insurance commission\).](#)

<sup>2</sup> [Paragraph .07 of AR-C section 60.](#)

<sup>3</sup> [Paragraphs .07 of AR-C section 70, .05 of AR-C section 80, and .05 of AR-C section 90.](#)

d. **Contractual basis.** A basis of accounting that the entity uses to comply with an agreement between the entity and one or more third parties other than the accountant.

e. **Other-basis.** A basis of accounting that uses a definite set of logical, reasonable criteria that is applied to all material items appearing in financial statements.

The cash-basis, tax-basis, regulatory-basis, and other-basis of accounting are commonly referred to as *other comprehensive bases of accounting*.

The preceding definitions are consistent with the corresponding definitions in the extant auditing literature.

A key difference between the international literature and the SASs/SSARSs is that the international literature recognizes that the financial reporting framework can be either a *fair presentation framework* or a *compliance framework*. The underlying presumption of a *fair presentation framework* is that in certain circumstances it may be necessary to provide disclosures in addition to those required by the applicable financial reporting framework in order to achieve fair presentation. This “stand back” assessment recognizes that the financial reporting framework cannot anticipate the particular facts and circumstances of an entity, and that judgment is needed to evaluate whether additional disclosures are needed to enable users of the financial statements to understand the effect of transactions, events, or conditions on the entity’s financial position, results of operations, and cash flows. The underlying presumption of a *compliance framework* is that the developers of the framework intend for the financial statements to be prepared in a manner that meets the requirements of only that framework, and that users are interested in knowing whether those requirements only have been met. Therefore, it would be inappropriate to override or supplement the requirements of the framework (e.g., provide additional disclosures) because doing so could lead to a lack of comparability and be contrary to the intent of meeting the financial information needs of users of financial statements prepared in accordance with that framework.

The historical view in the United States has been that certain special purpose frameworks (i.e., cash- and tax-basis) are always considered *fair presentation frameworks*. This view recognizes that those frameworks are based on criteria that are available and generally understood by users (e.g., general understanding in the case of cash basis, and the tax code in the case of tax basis), and that there is wide use and acceptance of financial statements prepared in accordance with those frameworks. To clarify this point, the proposed revisions to AR-C section 60 includes a new application paragraph .A12.

On the other hand, financial statements prepared using a regulatory or contractual basis of accounting may be more likely to be designed to meet the particular needs of specific users (e.g., regulators or parties to the contractual agreement). Questions have arisen in the United States about whether these frameworks are more similar to the international concept of a *compliance framework* because financial statements prepared under those frameworks are designed primarily for a specific purpose (or specific users) and may not require all of the relevant disclosures required by GAAP.

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The ARSC proposes revisions to AR-C sections 60, 80, and 90 to introduce the concept of *compliance frameworks* in the SSARs with respect to regulatory and contractual bases of accounting. The implications of this proposal are as follows:

- The requirement that the accountant modify the compilation or review report when the accountant becomes aware that the financial statements do not include informative disclosures similar to those required by GAAP when the financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP would apply only to *fair presentation frameworks* (which would include the cash- and tax-bases of accounting but would not include regulatory or contractual frameworks).
- For special purpose financial statements prepared in accordance with a contractual basis of accounting, the required separate paragraph (emphasis-of-matter paragraph in the review literature) in the accountant's report when financial statements are prepared in accordance with a special purpose framework would be required to include a statement that the financial statements may not be suitable for another purpose.
- While the requirement for the accountant's review report on special purpose financial statements to include an other-matter paragraph that restricts the use of the accountant's review report would be retained for reports on special purpose financial statements prepared in accordance with a contractual basis of accounting, reports on special purpose financial statements prepared in accordance with a regulatory basis of accounting would not be required to include such a paragraph.

**Request for Comment 8**

Please provide your views on the proposed revisions to incorporate the concept of *compliance frameworks* in the SSARs literature.  
Issue #9 – Proposed effective date.

If issued as final, the proposed revised AR-C sections would be effective for compilations and reviews of financial statements for periods ending on or after December 15, 2020.<sup>4</sup> Early implementation would be permitted.

**Request for Comment 9**

Are respondents supportive of the proposed effective date? If you are not supportive, please provide reasons for your response.

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## Guide for Respondents

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, when appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the

<sup>4</sup> This proposed effective date is provisional but will not be earlier than December 15, 2020.

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ARSC to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA for one year, beginning April 19, 2019. Responses should be sent to Mike Glynn at [mike.glynn@aicpa-cima.com](mailto:mike.glynn@aicpa-cima.com) and received by April 19, 2019.

**Comment Period**

The comment period for this exposure draft ends April 19, 2019.

**Accounting and Review Services Committee  
(2018–2019)**

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