Significant Change to Compilation Reporting Requirements When Independence Is Impaired

During its November 2009 meeting, the AICPA’s Accounting and Review Services Committee (ARSC) removed, at the urging of many local and smaller firm CPAs and certain user groups, a prohibition against stating the reasons why an accountant was not independent when performing a compilation service.

Many accountants are finding that their independence with respect to a compilation client is impaired for a number of reasons. Examples of impairments include the performance of certain nonattest services, ownership in the client’s business, or having certain relationships with the client. Prior to the issuance of Statement on Standards for Accounting and Review Services (SSARS) No. 19, *Compilation and Review Engagements* (AICPA, *Professional Standards*, vol. 2), an accountant was prohibited from including in his or her compilation report the reasons for an impairment of independence. An accountant could only state that he or she was not independent. Consequently, users who wanted to understand the reasons for an independence impairment needed to contact the client or the accountant for more information. Because of this interest on the part of users and to improve the overall transparency in the compilation report, the ARSC decided to remove the prohibition and allow an accountant, if he or she chooses, to state the reasons for an independence impairment in the compilation report.

Although most provisions of SSARS No. 19 will not be effective until on or after December 15, 2010, the ARSC felt that it was important to permit accountants to disclose the reasons for an independence impairment in the compilation report as soon as practicable. Therefore, the standard has an exception that this specific provision (set forth in paragraph 2.21 of SSARS No. 19—see Exhibit A) may be implemented early. This paper discusses, in a question and answer format, this specific paragraph and the alternatives that will now be available to accountants.

Question—To what compilation engagements does SSARS No. 19 apply?

Answer—SSARS No. 19 applies to compilations of financial statements and other specified elements, accounts, or items of a financial statement and pro forma financial information performed in accordance with SSARSs. SSARS No. 19 does not apply to engagements to compile prospective financial information. Such engagements would be performed in accordance with AT section 301, *Financial Forecasts and Projections* (AICPA, *Professional Standards*, vol.1). Paragraph .23 of AT section 301 states that the reason for a lack of independence should not be described in the compilation report.

Question—When may I start describing the reasons for lack of independence in my compilation report?
Answer—Once the new standard is issued, you may begin using the provision in paragraph 2.21. It is expected that SSARS No. 19 will be issued in late December or early January. Once it is officially issued, you will be able to use this new provision.

Question—May I disclose the reasons for the lack of independence only for December 2009 compilations and subsequent periods, or may I use it for earlier compilations (for example, November 2009 compilations)?

Answer—You may disclose the reasons for a lack of independence in a November (or earlier) compilation report as long as your report is released (or reissued) after the official issuance of SSARS No. 19. For example, assuming SSARS No. 19 is officially released on January 6, 2010, the provision to disclose the reasons may be used for any compilation report released (or reissued) after that date.

Question—What constitutes “official issuance,” and how will I know that date?

Answer—Official issuance is the date on which a standard is first made public and, therefore, available for use. A standard is first made available electronically through the AICPA’s subscription services. Even if you do not subscribe to an electronic subscription, you can still use this provision once the standard is issued. After the standard is issued, the AICPA’s Audit and Attest Standards Team will send a blast e-mail to members about the issuance date. Notification also will be made public through many other AICPA publication processes.

Question—May I use the new standard compilation report illustrated in SSARS No. 19 after the standard is issued?

Answer—No. The effective date of SSARS No. 19 is for compilations and reviews of financial statements for periods ending on or after December 15, 2010. Early implementation of the new standard is not permitted, except for the one paragraph permitting disclosure of the reasons for a lack of independence in the compilation report. Therefore, you cannot use the new standard compilation report until SSARS No. 19 becomes effective.

Question—Does SSARS No. 19 require me to state the reasons why I’m not independent with respect to a compilation client?

Answer—No. SSARS No. 19 permits, but does not require, the accountant to disclose the reasons. You may simply state that you are not independent with respect to the client without disclosing the reasons.

Question—May I disclose the reasons for the lack of independence in one period and then not disclose the reasons in a subsequent period for the same client?

Answer—Yes. Each period for which a compilation report is issued for a client is treated as a separate compilation. For example, you may decide to disclose the reasons in a compilation report on financial statements for the period ended March 31, 2010, and then decide to not disclose the reasons in a compilation report on financial statements for the period ended June 30, 2010, or vice versa.
Question—Are there factors that I should consider before deciding to disclose the reason(s) for the impairment?

Answer—An accountant should exercise his or her professional judgment in making that decision. That judgment might include consideration of such factors as the number of reasons for independence impairment or the ability of the user of the compiled financial statements to understand the nature of the impairments.

Paragraph 2.21 of SSARS No. 19 states in part, “If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.” Therefore, if the accountant’s independence is impaired for three reasons (for example, ownership, nonattest services, and family relationships), the accountant may decide that describing all three would make the report too lengthy or too confusing. Consequently, the accountant might decide to stay with the extant language and merely say that he or she is not independent. On the other hand, an accountant who is providing a nonattest service that impairs independence may feel that this information would be beneficial for users to know. Therefore, that accountant may decide to disclose the reason.

Question—Are there any limitations on what the report may say?

Answer—No. The ARSC did not prescribe any requirements except that if an election is made to describe, then all the reasons for the impairment must be described. That means that an accountant could, if he or she chooses, write a paragraph three pages long to describe the reasons for the impairment. Although that length certainly isn’t expected, the ARSC anticipates and expects that some accountants will go into far greater detail than will others.

Question—Assuming an accountant is not independent for two reasons (for example, a family relationship and ownership) does each reason need to be in a separate paragraph?

Answer—No. An accountant may combine the reasons into a single paragraph. For example, assuming the accountant held an ownership interest in the client and the accountant’s spouse was the CFO of the company, a description paragraph may be drafted, such as the following:

I am not independent with respect to XYZ Company as of and for the year ended December 31, 2010, because I am a minority shareholder in XYZ Company and my spouse is an officer of XYZ Company.

Question—Assuming an accountant’s independence is impaired because the accountant maintains a number of controls for the client, does each area of internal control need to be listed by the accountant, or may the accountant merely say that his or her independence is impaired because he or she maintained internal controls?

Answer—The provision is flexible and allows an accountant to provide as much detail as he or she feels appropriate in the circumstances. Therefore, the accountant may either state the areas of internal control maintained by the accountant or provide a general description of the reason or give no reason at all and merely say that he or she is not independent. In making this decision, the accountant should make sure that his or her description is not misleading. For example, if the accountant is maintaining only small aspects of internal control over financial reporting, the
accountant would not want to describe the reason by saying that he or she is maintaining all controls for the client. Such a statement would be misleading and inaccurate.

Question—May this provision be used for review reports as described in the exposure draft?

Answer—No. Although the exposure draft did include a situation whereby an accountant could design or operate aspects of internal control over financial reporting for a client and also perform a review, this provision was not included in the final standard. Paragraph 3.2 of SSARS No. 19 states that the accountant is precluded from performing a review engagement if the accountant’s independence is impaired for any reason.

Question—Where should I go if I have additional questions?

Answer—Members having additional questions regarding any of the provisions of SSARS No. 19 should contact the AICPA’s hotline at 1-877-242-7212, through e-mail at aahotline@aicpa.org, or through the following Web site: www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+and+Auditing+Technical+Help/

Question—Will additional guidance be issued?

Answer—Yes. Guidance is currently being developed and will be available immediately after busy season (late April or early May). The AICPA is developing a new Compilation and Review Guide, as well as new continuing professional education programs, to help practitioners understand the new compilation and review standard. Additionally, sessions are being scheduled at all major 2010 AICPA technical conferences.
Exhibit A: Reporting on Compiled Financial Statements When the Accountant Is Not Independent

[Note to readers: The following is paragraph 2.21 of Statement on Standards for Accounting and Review Services No. 19, Compilation and Review Engagements (AICPA, Professional Standards, vol. 2).]

2.21. When the accountant is issuing a report with respect to a compilation of financial statements for an entity, with respect to which the accountant is not independent, the accountant’s report should be modified. The accountant should indicate his or her lack of independence in a final paragraph of the accountant’s compilation report. An example of such a disclosure would be

I am (We are) not independent with respect to XYZ Company.

The accountant is not precluded from disclosing a description about the reason(s) that his or her independence is impaired. The following are examples of descriptions the accountant may use:

a. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (a member of the engagement team) had a direct financial interest in XYZ Company;

b. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because an individual of my immediate family (an immediate family member of one of the members of the engagement team) was employed by XYZ Company; or

c. I am (We are) not independent with respect to XYZ Company as of and for the year ended December 31, 20XX, because I (we) performed certain accounting services (the accountant may include a specific description of those services) that impaired my (our) independence.

If the accountant elects to disclose a description about the reasons his or her independence is impaired, the accountant should ensure that all reasons are included in the description.