

Checkpoint Contents

Accounting, Audit & Corporate Finance Library

Editorial Materials

Accounting and Financial Statements (US GAAP)

Cash, Tax, and Other Bases of Accounting

Chapter 1 An Introduction to Special Purpose Financial Statements

100 Background Information

100 Background Information

100.1 Bases of accounting other than GAAP, which are now primarily referred to in the authoritative literature as *special purpose frameworks* (see the discussion in paragraph 100.3), are a widely used alternative to the numerous and sometimes complex accounting requirements prescribed by generally accepted accounting principles (GAAP). Also contributing to the use of non-GAAP financial reporting is the availability of inexpensive accounting software, which allows individuals more familiar with tax laws than GAAP to maintain records and prepare financial statements with relative ease.¹ Compared to the voluminous amount of GAAP basis guidance available, limited authoritative guidance exists for using special purpose frameworks.

100.2 The use of special purpose frameworks is discussed in the audit standards and the SSARS. AU-C 210, *Terms of Engagement*, requires the auditor to determine the acceptability of the financial reporting framework applied in the preparation of the financial statements. Ordinarily, that framework is provided by GAAP; but AU-C 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*, and SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, allow special purpose frameworks to be used. AU-C 800.07, AR-C 70.07, AR-C 80.05, and AR-C 90.05 describe the following special purpose frameworks:

- **Cash Basis.** A basis of accounting used by the reporting entity to record cash receipts and disbursements. It includes modifications of the cash basis having substantial support (for example, recording depreciation on fixed assets), commonly known as the *modified cash basis*.
- **Tax Basis.** A basis of accounting the reporting entity uses to file its tax return for the period covered by the financial statements.
- **Regulatory Basis.** A basis of accounting used by the reporting entity 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).
- **Contractual Basis.** A basis of accounting used by the entity to comply with an agreement between the entity and one or more third parties other than the practitioner.

- *Other Basis*. A basis of accounting utilizing a definite set of logical and reasonable criteria that is applied to all material items within the financial statements.

100.3 Until recently, only the FASB Codification and the auditing standards, predominantly used the term *special purpose framework*. SSARS No. 21, however, has also adopted use of that term and when the SSAE Clarity Project is complete, the new clarified attestation standards will also use *special purpose framework*. This *Guide* has also predominantly switched to the use of *special purpose framework*. The occasional use of one term over the other in this *Guide*, however, has no particular significance. According to AU-C 800.07 and SSARS No. 21, the cash, tax, regulatory, and other bases of accounting are also commonly referred to as *other comprehensive bases of accounting* (or OCBOAs). Additionally, the use of OCBOA continues to commonly be used in practice.

100.4 As mentioned in the footnote to paragraph 100.1, practitioners who are involved with financial statements that are prepared using a special purpose framework still need to be familiar with GAAP requirements. When special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, AU-C 800.17 and SSARS No. 21 (AR-C 80.18d and AR-C 90.40d) state that the financial statements should include informative disclosures similar to those required by GAAP. In addition, AU-C 800.17 and SSARS No. 21 [AR-C 80.08(a)(iii) and AR-C 90.09(a)(iii)] state that additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements, or other disclosures, might be necessary for the financial statements to achieve fair presentation.

FASB Codification (GAAP)

100.5 GAAP measurement and disclosure requirements can be found in the *FASB Accounting Standards Codification*. The *FASB Accounting Standards Codification* (FASB ASC or the Codification) is the single source of authoritative nongovernmental U.S. generally accepted accounting principles (GAAP). Other accounting literature not included in the Codification is nonauthoritative.

Generally Accepted Auditing Standards

100.6 **Auditing Standards and Special Purpose Framework Engagements** AU-C 800 provides guidance for auditing special purpose financial statements. Some of the items in AU-C 800 that impact special purpose framework audit engagements include:

- *Terminology*. As mentioned in paragraph 100.3, throughout the auditing standards, the use of the term *other comprehensive basis of accounting* has generally been replaced by the term *special purpose framework*, although use of OCBOA is still appropriate for the cash, tax, regulatory, and other bases of accounting.
- *Acceptability of the Reporting Framework*. AU-C 800.10 requires the auditor to determine whether the special purpose framework used to prepare the entity's financial statements is acceptable by obtaining an understanding of (a) the purpose for which the financial statements are prepared, (b) the intended users, and (c) the steps taken by management to determine that the framework is acceptable in the circumstances.
- *Preconditions for the Audit*. AU-C 800.11 requires the auditor to obtain management's agreement that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate

for the special purpose framework used to prepare the financial statements. Management's acknowledgment and understanding should also cover any additional disclosures necessary to achieve fair presentation in the financial statements. The auditor should evaluate whether such disclosures are necessary.

- *Regulatory and Contractual Bases.* When the special purpose framework is the regulatory or contractual basis, certain performance, reporting, and/or presentation requirements exist under AU-C 800. Those requirements are discussed in Chapters 6, 7, and 9.

- *Reporting.* Several requirements exist in the area of reporting that impact all types of special purpose frameworks pursuant to AU-C 800. Those requirements are discussed in Chapter 7.

100.7 Exhibit 1-1 provides a listing of the auditing standard requirements of AU-C 800 for special purpose framework engagements.

Exhibit 1-1

Audits of Financial Statements Prepared Using a Special Purpose Framework

Requirements/Guidance	AU-C Reference
Definitions:	
<i>Special purpose framework</i> —a financial reporting framework other than GAAP that is one of the following bases of accounting—	AU-C 800.07
<ul style="list-style-type: none"> • <i>Cash basis</i>—A basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support. 	AU-C 800.07a
<ul style="list-style-type: none"> • <i>Tax basis</i>—A basis of accounting that the entity uses to file its tax return for the period covered by the financial statements. 	AU-C 800.07b
<ul style="list-style-type: none"> • <i>Regulatory basis</i>—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. 	AU-C 800.07c
<ul style="list-style-type: none"> • <i>Contractual basis</i>—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 auditor. 	AU-C 800.07d
<ul style="list-style-type: none"> • <i>Other basis</i>—A basis of accounting that utilizes a definite set of logical and reasonable criteria that is applied to all material items appearing in financial statements. 	AU-C 800.07e
Reference to <i>financial statements</i> in AU-C 800 means a complete set of special purpose financial statements, including the related notes	AU-C 800.08

of special purpose financial statements, including the related notes. The related notes ordinarily comprise a summary of significant accounting policies and other explanatory information. The requirements of the applicable financial reporting framework determine the form and content of the financial statements and what constitutes a complete set of financial statements.

Requirements:

Considerations When Accepting the Engagement

AU-C 210, *Terms of Engagement*, requires the auditor to determine whether the financial reporting framework used in the preparation of the financial statements is acceptable. For an audit of special purpose financial statements, the auditor should obtain an understanding of—

AU-C 800.10

- the purpose for which the financial statements are prepared,
- the intended users, and
- the steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.

AU-C 210 requires the auditor to establish whether the preconditions for an audit are present, including whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable. When auditing special purpose financial statements, the auditor should obtain management's agreement that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements, including —

AU-C 800.11

- A description of the special purpose framework, including a summary of significant accounting policies, and how the framework differs from GAAP, the effects of which need not be quantified.

AU-C 800.11a

- Informative disclosures similar to those required by GAAP, in the case of special purpose financial statements that contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP.

AU-C 800.11b

- A description of any significant interpretations of the contract on which the special purpose financial statements are based, in the case of special purpose financial statements prepared in accordance with a contractual basis of accounting.

AU-C 800.11c

- Additional disclosures beyond those specifically required by the framework that may be necessary for the special purpose financial statements to achieve fair presentation.

AU-C 800.11d

Considerations When Planning and Performing the Audit

AU-C 200, *Overall Objective of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, requires the auditor to comply with all AICPA sections

AU-C 800.12

standards, requires the auditor to comply with all AU-C sections pertinent to the audit. Accordingly, in planning and performing an audit of special purpose financial statements, the auditor should adapt and apply all AU-C sections relevant to the audit as necessary in the circumstances of the engagement.

AU-C 800.13

AU-C 300, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity's selection and application of accounting policies. In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements. An interpretation is significant when adoption of another reasonable interpretation would result in a material difference in the information presented in the financial statements.

Forming an Opinion and Reporting Considerations

AU-C 800.14

When forming an opinion and reporting on special purpose financial statements, the auditor should apply the requirements of AU-C 700, *Forming an Opinion and Reporting on Financial Statements*. When, in forming an opinion, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary, the auditor should apply the requirements of AU-C 705, *Modifications to the Opinion in the Independent Auditor's Report*.

AU-C 800.15

AU-C 700 requires the auditor to evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework. In an audit of special purpose financial statements, the auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. The effects of these differences need not be quantified.

AU-C 800.16

In the case of special purpose financial statements prepared in accordance with a contractual basis of accounting, the auditor should also evaluate whether the financial statements adequately describe any significant interpretations of the contract on which the financial statements are based.

AU-C 800.17

AU-C 700 requires the auditor to evaluate whether the financial statements achieve fair presentation. In an audit of special purpose financial statements when the special purpose financial statements contain items that are the same as, or similar to, those in financial statements prepared in accordance with GAAP, the auditor should evaluate whether the financial statements include informative disclosures similar to those required by GAAP. The auditor should also evaluate whether additional disclosures, beyond those specifically required by the framework, related to matters that are not specifically identified on the face of the financial statements or other disclosures are necessary for the financial statements to achieve fair presentation.

AU-C 800.18

AU-C 700 addresses the form and content of the auditor's report. In the case of an auditor's report on special purpose financial

the case of an auditor's report on special purpose financial statements—

- The explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances, when management has a choice of financial reporting frameworks in the preparation of such financial statements.

AU-C 800.18a

- The auditor's report should also describe the purpose for which the financial statements are prepared or refer to a note in the special purpose financial statements that contains such information, when the financial statements are prepared in accordance with (a) a regulatory or contractual basis of accounting or (b) an other basis of accounting and the auditor is required to restrict use of the auditor's report (pursuant to AU-C 905.06 a-b).

AU-C 800.18b

Except for the circumstances described in AU-C 800.21, the auditor's report on special purpose financial statements should include an *emphasis-of-matter* paragraph, under an appropriate heading that—

AU-C 800.19

- indicates that the financial statements are prepared in accordance with the applicable special purpose framework,
- refers to the note to the financial statements that describes that framework, and
- states that the special purpose framework is a basis of accounting other than GAAP.

Except for the circumstances described in AU-C 800.21, the auditor's report on special purpose financial statements should include an *other-matter* paragraph, under an appropriate heading that restricts the use of the auditor's report when the special purpose financial statements are prepared in accordance with—

AU-C 800.20

- a contractual basis of accounting,
- a regulatory basis of accounting, or
- an other basis of accounting when required pursuant to AU-C 905.06 (bullets a-b).

If the special purpose financial statements are prepared in accordance with a regulatory basis of accounting, and such financial statements together with the auditor's report are intended for general use, the auditor should not include the *emphasis-of-matter* or *other-matter* paragraphs required by AU-C 800.19-.20. Instead, the auditor should express an opinion about whether such financial statements are presented fairly, in all material respects, in accordance with GAAP. Additionally, in a separate paragraph, the auditor should express an opinion about whether the financial statements are prepared in accordance with the special purpose framework.

AU-C 800.21

If the auditor is required by law or regulation to use a specific layout, form, or wording of the auditor's report, the auditor's report should refer to GAAS only if the auditor's report includes, at a minimum, each of the following elements—

- A title.
- An addressee.
- An introductory paragraph that identifies the special purpose financial statements audited.
- A description of the responsibility of management for the preparation and fair presentation of the special purpose financial statements.
- A reference to management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when required by AU-C 800.18a.
- A description of the purpose for which the financial statements are prepared when required by AU-C 800.18b.
- A description of the auditor's responsibility to express an opinion on the special purpose financial statements and the scope of the audit, which includes (1) a reference to GAAS and, if applicable, the law or regulation and (2) a description of an audit in accordance with those standards.
- An opinion paragraph containing an expression of opinion on the special purpose financial statements and a reference to the special purpose framework used to prepare the financial statements (including identifying the origin of the framework) and, if applicable, an opinion on whether the special purpose financial statements are presented fairly, in all material respects, in accordance with GAAP when required by AU-C 800.21.
- An *emphasis-of-matter* paragraph that indicates that the financial statements are prepared in accordance with a special purpose framework when required by AU-C 800.19.
- An *other-matter* paragraph that restricts the use of the auditor's report when required by AU-C 800.20.
- The auditor's signature.
- The auditor's city and state.
- The date of the auditor's report.

If the prescribed specific layout, form, or wording of the auditor's report is not acceptable or would cause an auditor to make a statement that he or she has no basis to make, the auditor should reword the prescribed form of report or attach an appropriately worded separate report

SSARS Clarity Project and Issuance of SSARS No. 21

100.8 In October 2014, the Accounting and Review Services Committee (ARSC) issued SSARS No. 21, *Statements on Standards for Accounting and Review Services: Clarification and Recodification*, which is effective for periods ending on or after December 15, 2015. Early implementation is permitted. SSARS No. 21 supersedes all of the existing SSARS other than SSARS No. 14, *Compilation of Pro Forma Financial Information*. The project which will address SSARS No. 14 is discussed in paragraph 100.10. This *Guide* has been updated to enable accountants who perform SSARS engagements of special purpose framework financial statements to comply with the requirements of SSARS No. 19 and the requirements of SSARS No. 21.

100.9 In addition, ARSC has twice exposed and withdrawn a proposed clarified association SSARS. After a couple of attempts and numerous comments, it is ARSC's belief that how a firm chooses to address the matter of association is a risk management decision. Consequently, ARSC does not presently plan to issue an association standard.²

100.10 Furthermore, ARSC is working on projects to clarify the standard on compilations of pro forma financial information, and to include the assembly and compilation of prospective financial information guidance that is currently in the Attestation Standards (AT) into the SSARS. ARSC is hoping to issue an exposure draft that includes the compilations of pro forma financial information guidance and the preparation and compilation of prospective financial information guidance during the fall of 2015. In addition, ARSC is investigating whether there are additional requirements in the extant literature that should be included in a future Omnibus SSARS.

SSARS No. 21

100.11 As previously mentioned, SSARS No. 21 is effective for engagement periods ending on or after December 15, 2015, with early implementation permitted. It supersedes all of the existing AR sections other than AR 120, *Compilation of Pro Forma Financial Information*. SSARS No. 21 uses AR-C references to differentiate them from the extant literature. This is the same method that the AICPA used to differentiate between the old (AU references) and clarified auditing standards (AU-C references). Part of ARSC's goal when drafting SSARS No. 21 was to present the requirements and application and other explanatory guidance in a very concise manner, especially as it relates to preparation and compilation engagements. As a result, much of the guidance formerly included in Interpretations, as well as some other guidance such as the guidance related to comparative financial statements, is not carried forward into SSARS No. 21. Instead, many of those topics are addressed in the AICPA Guide, *Preparation, Compilation, and Review Engagements* (AICPA Guide).

100.12 SSARS No. 21 is comprised of four sections, each of which is further explained in the following paragraphs:

- 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*.

100.13 **AR-C 60, General Principles for Engagements Performed in Accordance with Statements on Standards for Accounting and Review Services** AR-C 60 provides general principles for any engagements performed in accordance with the SSARS and is intended to help accountants understand their professional responsibilities when performing SSARS engagements. AR-C 60 addresses—

- *Financial Statements*. The financial statements belong to the entity. The SSARS do not impose responsibilities on management of the entity, and do not override laws and regulations that govern the entity.
- *Ethical Responsibilities*. The accountant should comply with ethical requirements.
- *Professional Judgment*. The accountant should exercise professional judgment when performing a SSARS engagement.
- *Conduct of the Engagement in Accordance with the SSARS*. The accountant should comply with all relevant sections of the SSARS. In addition, the accountant should understand the requirements of the SSARS and the application and other explanatory materials in order to properly apply the requirements of the SSARS.
- *Engagement-level Quality Control*. Similar to engagement-level quality control requirements added to the auditing standards in AU-C 220 when those standards were clarified, SSARS No. 21 has incorporated requirements at the engagement-level that focus on the elements of quality control under SQCS No. 8 (QC 10). See further discussion in section 901.
- *Acceptance and Continuance of Client Relationships and Engagements*. The accountant should not accept an engagement performed under SSARS No. 21 unless the specified requirements and conditions are met.

AR-C 60 provides the overall framework for conducting an engagement in accordance with the SSARS.

100.14 **AR-C 70, Preparation of Financial Statements** AR-C 70 applies when an accountant is engaged to prepare financial statements, but is not engaged to perform an audit, review, or compilation of those statements.
³ (There are other more narrow exemptions from the requirements of AR-C 70 listed at AR-C 70.01). It establishes the performance requirements for the preparation of financial statements. An accountant engaged to prepare the financial statements should—

- a. Establish an understanding with the client regarding the services to be performed and document the understanding through a written communication signed by both the accountant or the accountant's firm and management or those charged with governance.

- b. Have, or obtain, an understanding of the applicable financial reporting framework and significant accounting principles and practices intended to be used to prepare the financial statements.

- c. Prepare the financial statements using the records and other information provided by management.

- d. Ensure that a statement is included on each page of the financial statements indicating that no assurance is provided. (If such a statement is not included, the accountant should either issue a disclaimer or perform a compilation engagement.)

- e. If the financial statements are prepared in accordance with a special purpose framework (such as cash basis or income tax basis), include a description of the financial reporting framework on the face of the financial statements or in a note to the financial statements.

- f. If the accountant assists management with significant estimates regarding amounts or disclosures in the financial statements, ensure that management understands and accepts responsibility for those estimates.

- g. Request additional or corrected information when the accountant becomes aware that information supplied by the client is incorrect, incomplete, or otherwise unsatisfactory.

- h. If the accountant prepares financial statements that contain a known departure or departures from the applicable financial reporting framework, disclose the departure.

- i. If the accountant prepares financial statements that omit substantially all disclosures required by the applicable financial reporting framework, disclose such omission on the face of the financial statements or in a note to the financial statements.

- j. Prepare documentation in sufficient detail to provide a clear understanding of the work performed.

Under certain circumstances, preparation engagements may be subject to peer review as discussed beginning at paragraph 901.36. This *Guide* provides limited information about preparation engagements. *PPC's Guide to*

SSARS *Preparation Engagements* covers AR-C 70 engagements in detail. Visit the website at tax.thomsonreuters.com for additional information or to purchase the *Guide*.

100.15 **AR-C 80, *Compilation Engagements*** AR-C 80 establishes the standards and provides guidance on compilations of financial statements. The accountant is required to comply with the provisions of AR-C 80 whenever he or she is engaged to report on compiled financial statements. Compilation reporting requirements are discussed in Chapter 7; and certain considerations for compilation engagements are discussed in Chapter 9.

100.16 **AR-C 90, *Review of Financial Statements*** AR-C 90 establishes the standards and provides guidance on reviews of financial statements. The accountant is required to comply with the provisions of AR-C 90 whenever he or she is engaged to review financial statements, except for the reviews of interim financial information when AU-C 930 applies. Review reporting requirements are discussed in Chapter 7; and certain considerations for review engagements are discussed in Chapter 9.

100.17 Exhibit 1-2 provides a listing of the SSARS No. 21 requirements that are specific to performing engagements of special purpose framework financial statements.

Exhibit 1-2

SSARS Engagements of Financial Statements Prepared Using a Special Purpose Framework ^a

Requirements/Guidance	AR-C Reference
Definitions:	
<p><i>Special Purpose Framework</i>—A financial reporting framework other than GAAP which is one of the following:</p> <ul style="list-style-type: none"> • <i>Cash basis</i>—A basis of accounting used by the reporting entity to record cash receipts and disbursements. Additionally, modifications of the cash basis having substantial support. • <i>Income tax basis</i>—The basis of accounting the entity uses to prepare its tax returns for the period covered by the financial statements. • <i>Regulatory basis</i>—A basis of accounting used by the entity to comply with requirements of a regulatory agency to whose jurisdiction the entity is subject. • <i>Contractual basis</i>—A basis of accounting used by the entity to comply with the financial reporting requirements of a contract between the entity and one or more third parties other than the practitioner. • <i>Other basis</i>—A basis of accounting with a definite set of logical, reasonable criteria that is applied consistently to all financial statement items. 	<p>AR-C 70.07; AR-C 80.05; AR-C 90.05</p>
Requirements:	

Considerations When Accepting the Engagement	
<p>Prior to accepting the engagement, the accountant should determine whether the financial reporting framework is acceptable. This determination could include consideration of:</p> <ul style="list-style-type: none"> • The purpose of the financial statements (i.e., limited number of users or wide range of users.) • Whether a particular financial reporting framework is prescribed by law or regulation. 	AR-C 60.25b; AR-C 60.A47
<p>Prior to accepting the engagement, the accountant should obtain agreement from management that it is responsible for the selection of the financial reporting framework.</p>	AR-C 60.25c(i)
Agreement on Engagement Terms	
<p>The engagement letter should include the identification of the financial reporting framework to be used to prepare the financial statements.</p>	AR-C 70.10f; AR-C 80.10e; AR-C 90.11e
<p>The engagement letter should include management's agreement that it is responsible for the preparation and presentation of the financial statements in accordance with the financial reporting framework.</p>	AR-C 80.08a; AR-C 90.09a
Fair Presentation of Financial Statements	
<p>In special purpose financial statements, fair presentation includes the following:</p>	
<ul style="list-style-type: none"> • The inclusion of all applicable financial statement disclosures. • A description of the financial reporting framework. This includes a summary of significant accounting policies and a description of how the framework differs from GAAP. Also, disclosures similar to those required by GAAP should be included if the financial statements include items that are the same as or similar to items in GAAP-basis financial statements. • A description of any significant interpretations of a contract upon which contractual basis financial statements are prepared. • Additional disclosures necessary to achieve fair presentation. 	AR-C 80.08a; AR-C 90.08a AR-C 80.08a(i); AR-C 80.18; AR-C 90.09a(i); AR-C 90.40 AR-C 80.08a(ii); AR-C 90.09a(ii) AR-C 80.08a(iii); AR-C 90.09a(iii)
Financial Statement Preparation Engagements	
<p>The financial statements should include a description of the financial reporting framework on the face of the financial statements or in a note to those statements.</p>	AR-C 70.15
Understanding the Financial Reporting Framework	
<p>The accountant should understand the applicable financial reporting framework and how the significant accounting policies are used in the preparation of the financial statements.</p>	AR-C 80.12; AR-C 90.15

Reporting on Compilation Engagements	
The accountant's report should refer to management's responsibility to determine that the financial reporting framework is acceptable if management had a choice of which financial reporting framework to use.	AR-C 80.20a
The accountant's report should include a separate paragraph (a) stating the financial statements were prepared using the applicable framework, (b) referencing a note to the financial statements describing the financial reporting framework (if applicable), and (c) stating the framework is not GAAP.	AR-C 80.21
The accountant's report should describe the purpose of the financial statements or refer to a note with this information if the financial statements were prepared in accordance with the regulatory or contractual basis of accounting.	AR-C 80.20b
The accountant's report should be modified if the financial statements do not include (a) a description of the financial reporting framework, (b) a summary of significant accounting policies, (c) an adequate description of how the basis used differs from GAAP, and (d) informative disclosures similar to those required by GAAP when the statements contain items that are the same as or similar to GAAP.	AR-C 80.18
The accountant's report should be modified if contractual basis financial statements do not adequately disclose significant interpretations of the contract upon which the financial statements are based.	AR-C 80.19
Reporting on Review Engagements	
The accountant's report should refer to management's responsibility to determine that the financial reporting framework is acceptable if management had a choice of which financial reporting framework to use.	AR-C 90.42a
The accountant's report should include an emphasis-of-matter paragraph (a) stating the financial statements were prepared using the applicable framework, (b) referencing a note to the financial statements describing the financial reporting framework, (c) stating the framework is not GAAP, and (d) indicating that the accountant's conclusion is not modified with respect to this matter.	AR-C 90.43; AR-C 90.53b
The accountant's report should describe the purpose of the financial statements or refer to a note with this information if the financial statements were prepared in accordance with the regulatory or contractual basis of accounting.	AR-C 90.42b
The accountant's report should be modified if the financial statements do not include (a) a description of the financial reporting framework, (b) a summary of significant accounting policies, (c) an adequate description of how the basis used differs from GAAP, and (d) informative disclosures similar to those required by GAAP when the statements contain items that are the same as or similar to GAAP.	AR-C 90.40

<p>The accountant's report should be modified if contractual basis financial statements do not adequately disclose significant interpretations of the contract upon which the financial statements are based.</p>	<p>AR-C 90.41</p>
<p>Include an other-matter paragraph restricting the use of the accountant's report if the financial statements are prepared in accordance with the regulatory or contractual basis of accounting or in accordance with an other basis of accounting and the measurement or disclosure are determined to be suitable for only those limited users with an adequate understanding of the criteria or the measurement or disclosure are only available to certain specified parties.</p>	<p>AR-C 90.44; AR-C 90.61</p>

Notes:

^a This Exhibit is intended to list incremental requirements that are applicable to SSARS engagements involving special purpose financial statements. For a more complete discussion of engagement requirements, see the reporting discussions in Chapter 7 and the engagement considerations in Chapter 9.

Code of Professional Conduct

100.18 The AICPA *Code of Professional Conduct* (the Code) applies to all individuals who are members of the American Institute of Certified Public Accountants. In addition, certain state CPA societies and state boards of accountancy have incorporated all, or parts of the Code into their own rules of conduct. Because of such similarity (and because it is not uncommon for a CPA to be a member of both the AICPA and one or more state societies), the AICPA and most of the state CPA societies have joined together to create the Joint Ethics Enforcement Program (JEEP). JEEP permits joint enforcement of the respective codes of professional conduct that a member is subject to and allows for a single investigation with investigative information shared between the AICPA and the state CPA societies.

100.19 In addition, the AICPA Professional Ethics Division receives referrals from the various state licensing boards as well as federal agencies such as the Securities and Exchange Commission and various Inspectors General. The AICPA's authority is limited to termination or suspension of an individual's membership, but the individual's state licensing board(s) can revoke a member's license for professional misconduct.

100.20 Maintaining independence is an important consideration for practitioners when performing services for attest clients. The Code provides requirements under the "Independence Rule" and its interpretations (ET 1.200) that AICPA members should follow in order to maintain their independence. Section 902 discusses independence issues in more detail, including the performance of nonattest services beginning at paragraph 902.15.

100.21 **AICPA Issues a New Code of Conduct** In June 2014, the AICPA Professional Ethics Executive Committee (PEEC) issued a revised AICPA *Code of Professional Conduct*. The primary goal of revising the AICPA's ethics guidance was to restructure the Code so members and other users of the Code can apply the rules and reach correct conclusions more easily and intuitively. This reformatting resulted in a number of improvements and some substantive revisions, while maintaining the substance of the existing AICPA ethics

standards.

100.22 New Structure. 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).

100.23 Effective Date. The revised Code generally became effective on December 15, 2014. However, two new conceptual frameworks and related interpretations will not be effective until December 15, 2015. 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 Code. This *Guide* has been updated for the revised Code, including application of the new conceptual framework for members in public practice. Firms can access the online version of the revised Code at pub.aicpa.org/codeofconduct/Ethics.aspx.

100.24 **Additional Changes to the Code** The following paragraphs provide information about additional Code revisions recently made. The information presented is at a high level. Detailed information about standards-related projects of the Professional Ethics Executive Committee (PEEC) may be accessed from the AICPA's website at www.aicpa.org/InterestAreas/ProfessionalEthics/Community/ExposureDrafts/Pages/ExposureDrafts.aspx

100.25 Revision Made to the AICPA Bylaws. The AICPA Council approved changes to “Appendix B—Council Resolution Concerning the Form of Organization and Name Rule” of the Code. The approval revises the list of attest services in Appendix B to match that of the Uniform Accountancy Act and now includes (a) any engagement to be performed in accordance with the PCAOB standards, and (b) any examination, review, or agreed-upon procedures engagement performed in accordance with the SSAEs. The revision became effective on January 31, 2015.

100.26 New Independence Interpretation. The PEEC has adopted a new interpretation, “Breach of an Independence Interpretation,” under the *Independence Rule*. The new interpretation provides guidance to members to evaluate and address the consequences of a breach of an independence interpretation, and is based on the requirements of QC 10. The new interpretation will become effective on March 31, 2016.

100.27 Revision to Client Affiliate and Campaign Treasurer Independence Interpretations. The PEEC has approved revisions to two independence interpretations, “Client Affiliate” and “Campaign Treasurer,” both of which became effective on April 30, 2015. The revision to the client affiliate interpretation carves out an exception to independence impairment for acquisitions and other business combinations that involve a financial statement attest client. The revisions to the campaign treasurer interpretation has expanded existing guidance to include treasurers and others with similar responsibilities in a political campaign, and added restrictions when the attest client is the campaign organization, a candidate running for election of a governmental entity, or a political party.

Addressing Accounting Standards Overload

100.28 On and off for decades, the AICPA has examined the issue of standards overload. A solution that has

often been mentioned is the use of financial statements prepared under a financial reporting framework other than GAAP. One of the earliest studies was performed by the AICPA's Special Committee on Accounting Standards Overload. In 1981, that committee was formed to consider alternative means of providing relief from accounting standards that were not cost-effective, particularly for small, closely held companies. In its final report published in 1983, the committee concluded:

Small, nonpublic entities can gain some measure of relief from accounting standards overload by issuing compiled, reviewed, or audited financial statements prepared on a comprehensive basis of accounting other than GAAP in accordance with existing disclosure and measurement standards and with the existing reporting requirements for CPAs.

100.29 In 1995, the Private Companies Practice Section of the AICPA appointed the Special Task Force on Standards Overload. Recognizing the increasing use of non-GAAP frameworks and the confusion surrounding required disclosures (especially in light of "disclosure only" accounting standards), the committee's August 1996 report included a recommendation that standard setters provide more specific guidance on disclosures in financial statements prepared using a financial reporting framework other than GAAP. In response to that request, the Audit Issues Task Force of the Auditing Standards Board issued Interpretation 14 of AU 623.

100.30 **Private Company Financial Reporting Task Force Report** In 2004, the AICPA appointed a Private Company Financial Reporting Task Force to gather information regarding the needs of users of financial statements of larger or public entities versus the needs of users of financial statements of smaller, nonpublic entities. The Task Force conducted a survey which found that certain types of financial statement users were more likely to accept non-GAAP financial statements for privately-held, for-profit companies. Specifically, 93% of creditor/lenders, 72% of surety/bonding firms, and 58% of investor/venture capital firms accepted such financial statements. The survey also indicated that the size of the company was a factor in the decision to accept financial statements prepared under a financial reporting framework other than GAAP for the majority of the financial statement users that accepted them.

100.31 The Task Force concluded that GAAP should specifically address the needs of private company financial statement users. That conclusion was based on findings that indicated many GAAP requirements were not relevant for nonpublic companies and, in some cases, it would be more useful to require different accounting for nonpublic entity transactions. As a result of those findings, the AICPA and FASB began working together to explore the development of accounting standards for privately held companies. In 2006, the two organizations issued a joint proposal intended to improve the financial reporting process for private companies. Subsequently, a joint committee was formed (the Private Company Financial Reporting Committee) to serve as a resource to the FASB to ensure that the views of private company constituents were considered during the standard-setting process. The Private Company Financial Reporting Committee (PCFRC) began making recommendations regarding accounting standards proposals to the FASB in 2007. However, the PCFRC ceased to exist as of December 31, 2012, after it was replaced by the Private Company Council, as further explained below.

100.32 **Blue Ribbon Panel** In December 2009, the AICPA and the Financial Accounting Foundation (FAF) announced the formation of the Blue Ribbon Panel to address how U.S. accounting standards can best meet the needs of users of private company financial statements. The purpose of the panel was to provide recommendations on the future of standard setting for private companies, including whether separate, stand-alone accounting standards for private companies were needed. After a series of meetings were held in 2010, the Blue Ribbon Panel delivered its report to the FAF early in 2011. The report called for fundamental changes to the system of standard setting, including creating a new board to be overseen by the FAF that would focus on making exceptions and modifications to U.S. GAAP for private companies that better responded to the needs of the private company sector. The report also recommended the creation of a *differential framework* (that is, a set

of decision criteria) to facilitate a standard setter's ability to make appropriate, justifiable exceptions and modifications. The FAF then embarked on an outreach program and released its proposal in the fall of that year. Roundtable meetings were held during the first quarter of 2012, and in May 2012, the FAF announced its decision to establish the Private Company Council.

100.33 Private Company Council The Private Company Council (PCC) was established to improve the process of establishing accounting standards for private companies. The responsibilities of the PCC are two-fold:

a. To determine whether modifications or exceptions to existing nongovernmental U.S. GAAP are warranted to address the needs of users of private company financial statements based on criteria mutually agreed to by the PCC and the FASB.

b. To serve as the primary advisory body to the FASB on the appropriate treatment for private companies for items under active consideration on the FASB's technical agenda.

100.34 The PCC has to-date taken on several projects and issued related proposals for changes that are intended to reduce accounting complexity for private companies. In 2015, the FAF began conducting an assessment to determine whether the PCC is meeting its primary responsibilities and mission, and to provide an assessment of its continuing role. Information about the PCC, its projects, and the FAF's current assessment is available at www.fasb.org/pcc.

100.35 FASB Private Company Decision-making Framework In response to the Blue Ribbon Panel's recommendation, the FAF instructed the FASB and the PCC to undertake a differential framework project, which was completed in December 2013, when the FASB and the PCC issued the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*. At the same time, the FASB also issued FASB ASU 2013-12, *Definition of a Public Business Entity: An Addition to the Master Glossary*. The *Private Company Decision-Making Framework* is intended to be used by the FASB and PCC to assist in determining whether and when to provide alternative requirements for recognition, measurement, presentation, disclosure, effective dates, or transition guidance for private companies reporting under U.S. GAAP. The *Definition of a Public Business Entity* will be used by the FASB, PCC, and the Emerging Issues Task Force to determine the scope of new accounting and reporting guidance and to identify the types of companies that are excluded from the scope of the new guidance. Further information about this process is available from the FASB's website at www.fasb.org.

100.36 AICPA Financial Reporting Framework for Small- and Medium-sized Entities The AICPA's *Financial Reporting Framework for Small- and Medium-Sized Entities* (FRF for SMEs™ or Framework) is an optional reporting framework, which provides another GAAP-alternative for small businesses. However, unlike the other common GAAP-alternative frameworks, the FRF for SMEs accounts for an entity's transactions according to their economic substance, which is the same objective as GAAP. While historical cost is the primary measurement basis, there are also some similarities to the accrual income tax basis. For certain accounting policies, the FRF for SMEs allows alternatives so that an individual business can select the policy they believe best meets the needs of the users of their financial statements.

100.37 The FRF for SMEs is not authoritative, so it has not been acted upon, approved, or disapproved by any senior technical committee of the AICPA or FASB. It has no effective date and the AICPA cannot require its use. Small- and medium-sized entities can choose to adopt it at any time. Practitioners can report on compiled,

reviewed, or audited financial statements prepared using the Framework because it meets the definition of a special purpose framework, as described in paragraph 100.2, in the *other basis* category.

100.38 Definition of a SME. The Framework does not define *small- and medium-sized entity*, and has no size thresholds that must be met for an entity to be considered an SME. However, the FRF for SMEs provides a list of characteristics that indicate an entity could be an SME, although the list is not all-inclusive and the criteria listed are not required to be met. According to the Framework, the following are characteristics of an SME:

- The entity is not required to prepare GAAP-based financial statements.
- The entity has no plans to go public in the foreseeable future.
- The entity is a for-profit entity.
- The owner(s) of the entity is also the person(s) who runs the entity.
- There is no highly-specialized accounting guidance for the industry in which the entity operates.
- There are no overly complicated transactions.
- There are no significant foreign operations.
- The financial statement users have direct access to management.

100.39 While one of the previous characteristics mentions that the entity is a for-profit entity, the authors believe there may be some nonprofit organizations that could use the Framework. For example, nonprofits that are not affected by specialized guidance on contributions and net asset classifications may find this to be an appropriate framework.

100.40 Major Differences from GAAP. While much of the guidance in the FRF for SMEs is similar to guidance under GAAP, there are also many differences. Some of the areas that the authors believe have the most significant differences include—

- Accounting for income taxes.
- Accounting for intangible assets acquired in a business combination.

- Amortization of goodwill.
- Reporting of subsidiaries.
- Accounting for and reporting of VIEs.
- Accounting for leases.
- Accounting for stock-based compensation.
- Accounting for defined benefit plans.
- Impairment of assets.
- Recurring adjustment for changes in the value of debt and equity investments.

100.41 Additional Information. The AICPA provides a free PDF of the Framework available for download, a listing of frequently asked questions and answers, three different FRF for SMEs toolkits, and more, all at www.aicpa.org/FRF-SMEs.

100.42 Thomson Reuters publishes *PPC's Guide to the Financial Reporting Framework for Small- and Medium-Sized Entities*. The publication provides detailed guidance on preparing financial statements based on the FRF for SMEs, including illustrations and other tools to assist in converting GAAP-basis financial statements to the FRF for SMEs, and to help accountants explain the FRF for SMEs to clients and financial statement users. Visit the website at tax.thomsonreuters.com for additional information about the *Guide* or to purchase.

International Financial Reporting Standards

100.43 The Council of the AICPA has designated the International Accounting Standards Board as the body to establish international financial reporting standards for both private and public entities pursuant to ET 1.310.001, *Compliance with Standards Rule*, and ET 1.320.001, *Accounting Principles Rule*, of the AICPA *Code of Professional Conduct*. This allows AICPA members the option of using International Financial Reporting Standards as an alternative to U.S. generally accepted accounting principles. This *Guide* does not address financial statements prepared in accordance with International Financial Reporting Standards.

- 1** Because special purpose framework financial statements should include disclosures similar to those required by GAAP when the financial statements contain items that are the same as or similar to GAAP, the authors believe accountants should not accept an engagement to prepare such financial statements unless they have a good foundation in generally accepted accounting principles.
- 2** Association occurs when an accountant's name is used in a document or written communication containing unaudited financial statements that the accountant has not prepared, compiled, reviewed, or audited.
- 3** When the accountant is engaged to prepare financial statements and is also engaged to perform an audit, review, or compilation of those statements, the financial statement preparation would be a nonattest service. See the discussion beginning at paragraph 902.15.

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Chapter 1 An Introduction to Special Purpose Financial Statements

101 Deciding When to Use a Special Purpose Framework

101 Deciding When to Use a Special Purpose Framework

101.1 The use of a special purpose framework is beneficial to clients for many reasons. Because accountants do not need to consider the measurement requirements of GAAP, special purpose financial statements often can be prepared on a more timely basis and at less cost to the client. For example, if depreciation is the only difference between GAAP and the client's tax return, using the income tax basis can eliminate the need to prepare two sets of depreciation schedules. Special purpose financial statements also may provide information in a format familiar to the client. For example, cash basis financial statements can answer the basic question "Where did the money go?"

101.2 The AICPA Practice Aid, *Accounting and Financial Reporting Guidelines for Cash- and Tax-Basis Financial Statements*, provides the following guidance on characteristics of entities that generally are good candidates for cash basis or income tax basis financial statements:

- a. There are no third-party users of the financial statements (for example, the entity is a small closely held business with no third-party debt).

- b. The entity's creditors do not require GAAP financial statements.

- c. The cost of complying with GAAP would exceed the benefits (for example, a small construction contractor who would be required to account for long-term contracts using the percentage of completion method and would be required to compute deferred taxes).

- d. The owners and managers are closely involved in the day-to-day operations of the business and have a fairly accurate picture of the entity's financial position.

- e. The business's owners are primarily interested in cash flows (for example, a professional corporation of physicians that distributes its cash basis earnings through salaries, bonuses, and retirement plan contributions).

- f. The owners are primarily interested in the tax implications of transactions (for example, partners in a partnership who are concerned about the effects of transactions on their personal tax returns).

- g. The entity is not required, and does not expect to be, to issue GAAP financial statements.

101.3 There are instances in which special purpose financial statements are not appropriate, however. The entity may have substantial unfunded obligations or commitments not recorded on the income tax basis (because they are not deductible until paid) or the cash basis (because they have not been paid). For example, under the accrual income tax basis (a) pension liabilities are recorded at the amount determined to be deductible, (b) leases are recorded under Internal Revenue Code (IRC) rules, (c) deferred compensation is recognized when paid, (d) potential environmental liabilities are recorded only when they meet the economic performance and all events tests of the IRC, and (e) interest due to a related party cannot be accrued and deducted. When such conditions exist, accountants should consider whether financial statements prepared using a special purpose framework could be misleading—especially if the financial statements omit substantially all disclosures.

101.4 In advising a client about the use of special purpose financial statements, accountants must have a clear idea about the user's needs. Perhaps a banker can use a cash basis financial statement generated by the client's computer system if the entity accompanies it with an aged accounts receivable listing. On the other hand, an absentee owner may be able to use compiled cash basis financial statements that omit substantially all disclosures on an interim basis but needs full disclosure GAAP statements at year end. Companies reporting financial results to third parties ordinarily use GAAP for financial statements. The use of GAAP promotes comparability among financial statements, and users become familiar with GAAP through experience with it. Additionally, loan covenants may require GAAP financial statements and failure to provide such statements may result in a loan default.

Considerations When Accepting an Audit Engagement

101.5 **Is the Financial Reporting Framework Acceptable?** AU-C 210, *Terms of Engagement*, requires the auditor to determine whether the financial reporting framework used in the preparation of the entity's financial statements is acceptable. AU-C 800.10 refers to that requirement and further indicates that when performing an audit of special purpose financial statements, the auditor should obtain an understanding of—

- a. The purpose for which the financial statements are prepared.

- b. The intended users of the financial statements.

- c. The steps management has taken to determine that the applicable financial reporting framework is acceptable in the circumstances.

101.6 AU-C 800.A6-.A9 provides further information about AU-C 800.10 indicating that the following factors could be used by the auditor when he or she considers whether the specific type of special purpose framework applied

in the preparation of the financial statements is acceptable—

- The financial information needs of the intended users.
- Whether the special purpose framework applied to the financial statements encompasses financial reporting standards that have been established by an authorized standard-setting organization that follows an established and transparent process, for example, the AICPA or the FASB. When such is the case, the financial reporting standards that support the special purpose framework applied will be presumed acceptable.
- When the financial reporting framework applied is required by law or regulation to be used in the preparation of the entity's special purpose financial statements, such a financial reporting framework is presumed acceptable (unless indications to the contrary exist). For example, this type of situation often occurs when a regulator establishes financial reporting provisions that must be met by those entities that it regulates.
- Whether the financial reporting framework applied exhibits attributes normally exhibited by acceptable financial reporting frameworks. However, for special purpose frameworks, the relative importance to a particular engagement of each of the attributes normally exhibited by acceptable financial reporting frameworks is a matter of professional judgment.
- For financial statements prepared in accordance with a contractual basis of accounting, the parties to the contract might agree on significant interpretations of the contract, if any, that are the basis of the special purpose framework. If the parties cannot reach agreement, the auditor may determine that the framework is not acceptable.

101.7 Preconditions for an Audit Engagement As mentioned in paragraph 101.5, under AU-C 210, the auditor is required to establish whether certain preconditions for an audit are present, including whether the financial reporting framework to be used in the preparation of the financial statement is acceptable. In performing an audit of special purpose financial statements, AU-C 800.11 refers to the requirement in AU-C 210 and further requires the auditor to obtain managements' agreement that it acknowledges and understands its responsibility to include all informative disclosures that are appropriate for the special purpose framework used to prepare the entity's financial statements. These precondition requirements are further discussed in paragraph 904.18.

Considerations When Accepting a SSARS No. 21 Engagement

101.8 Preconditions for a SSARS Engagement SSARS No. 21 (AR-C 60) specifies certain conditions for accepting an engagement under the SSARS. According to AR-C 60.25, one of the conditions requires the accountant to determine whether the framework selected by management for the preparation of the entity's financial statements is acceptable. The accountant may find the following factors relevant when making that determination (AR-C 60.A47)—

- The purpose of the financial statements.
- Whether the financial reporting framework applied is required by law or regulation.

Additionally, the authors believe the information provided by AU-C 800.A6-.A9 and discussed at paragraph 101.6, can also help the accountant determine the acceptability of the framework in a SSARS engagement.

101.9 In addition to the general preconditions for accepting a SSARS No. 21 engagement required by AR-C 60.25, AR-C 80.08 and AR-C 90.09 provide additional preconditions in compilation and review engagements if the financial statements are prepared using a special purpose framework. Those preconditions require certain disclosures regarding the applicable financial reporting framework. See further discussion in section 904.

When Is Each Basis Appropriate?

101.10 Absent specific guidance from financial statement users, accountants need to consider issues such as the following before advising a client about which presentation to use.

- *Does the Entity Have Inventory?* If so, the pure cash basis may not be helpful.
- *What Basis of Accounting Does the Entity Use in Preparing Its Income Tax Returns?* If the accrual basis is used, preparing financial statements on the same basis makes sense.
- *Is the Entity Highly Leveraged?* Lenders may require GAAP financial statements.
- *Are There Outside Investors?* GAAP financial statements may provide information needed by such users.
- *Does the Entity's Cash Flow Parallel Its Income and Expenses?* The pure cash basis may be appropriate.
- *Does the Entity Anticipate Going Public?* If so, the entity will need a history of GAAP financial statements.
- *Was the Entity Formed for Tax Purposes?* If the answer is yes, the owners probably are interested in the tax effects of transactions, and the income tax basis would be appropriate.
- *Is the Entity Subject to Bonding Requirements?* Many bonding companies will only accept GAAP financial statements.

101.11 **Cash and Modified Cash Bases** In practice, use of the pure cash basis is rare. Generally, it is limited to nonbusiness entities with very simple operations. Entities that might use the pure cash basis of accounting include school activity funds, fairs and other civic ventures, trusts and estates, political action committees, and political campaigns.

101.12 Use of the modified cash basis is more common. To help provide some consistency in its use, however, the authors recommend limiting it to entities whose operations are:

- a. oriented toward cash receipts and disbursements,
- b. not significantly influenced by financing of sales or purchases, and
- c. relatively simple and without complexities (complexities such as manufacturing, development, or other conversion activities or acquisitions of property and equipment, for example) that require significant modifications.

Chapter 4 discusses both the cash basis and the modified cash basis in detail.

101.13 **Income Tax Basis** Typically, entities that use the income tax basis of accounting are either profit-oriented enterprises (such as small closely held companies for which conversion to GAAP would exceed the benefit), partnerships whose partnership agreements require the use of the income tax basis of accounting, or nonprofit organizations seeking relief from the requirements of GAAP.

101.14 **Regulatory and Contractual Basis** Regulatory basis financial statements are prepared by many types of entities, including insurance companies, credit unions, construction contractors, certain state and local governmental entities, and some nonprofit organizations. Contractual basis financial statements are prepared when an entity follows the provisions of a contract or agreement, which often requires at least some unique financial reporting calculations. Due to the unique provisions in the contract or agreement, it is common that interpretation is necessary with regard to measurement principles for the contractual basis.

101.15 **Other Basis** Section 602 addresses the other basis of accounting and considers whether specific accounting frameworks meet the qualifications of an *other basis*. Additionally, the FRF for SMEs discussed beginning at paragraph 100.36 meets the criteria for the *other basis* type of special purpose framework.

Cost-effective Alternatives for Clients

101.16 As discussed in paragraph 101.1, special purpose financial statements are one option for providing more timely information at less cost to some clients. The following paragraphs discuss some additional options to consider when recommending a level of service to a client. For certain clients, these options may offer cost-effective means of meeting a client's needs.

101.17 **Using Special Purpose Frameworks for Interim Financial Statements and GAAP for Annual Financial Statements** One option that accountants may want to consider for some clients is using the cash, modified cash, or income tax basis of accounting for preparing interim financial statements and GAAP for preparing annual statements. Some accountants find that this is both efficient and cost effective. When the accountant performs a compilation engagement on the interim statements, it may be even more efficient and

cost-effective to omit substantially all disclosures from the interim statements. (However, see the discussion at paragraph 101.18.) Considerations when preparing and reporting on interim special purpose financial statements are discussed in Chapter 10.

101.18 Compiling Financial Statements That Omit Substantially All Disclosures If a client does not feel that full disclosure statements are cost-effective, then the accountant may be engaged to compile financial statements that omit substantially all of the disclosures required by a special purpose framework. The accountant should not issue an accountant's compilation report on financial statements that omit substantially all disclosures, however, unless the omission is not to the accountant's knowledge undertaken to mislead those who might reasonably be expected to use the financial statements. Additionally, other requirements relating to reporting on financial statements that omit substantially all disclosures should be followed, as discussed beginning at paragraph 701.18.

Planning Form for Engagements Involving OCBOA Financial Statements

101.19 Appendix 1A provides a planning questionnaire that may be used to determine whether use of a special purpose framework is appropriate.

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102 Primary Issues in Preparing Special Purpose Financial Statements

102 Primary Issues in Preparing Special Purpose Financial Statements

Recognition and Measurement

102.1 Transactions are recognized and measured in financial statements based on the basis of accounting used. Thus, cash basis financial statements do not recognize or measure transactions until cash is received or paid. Modified cash basis financial statements reflect transactions similarly except for certain transactions the entity elects to recognize and measure otherwise (for example, capitalizing property and equipment and charging their costs to expense over the periods benefited rather than expensing them in the period purchased). Income tax basis financial statements recognize transactions when they would be recognized in the entity's tax return, and then measure them based on amounts that would be reported in the return. GAAP recognition and measurement principles, such as the requirement of FASB ASC 715-30-25-1 to recognize an asset or a liability for the funded status of a defined benefit pension plan, are not considered in special purpose financial statements (except to the extent the cash basis has been modified to adopt GAAP principles).

102.2 Recognizing and measuring transactions under the cash or modified cash basis is discussed in Chapter 4 of this *Guide*. Chapter 5 discusses measurement and recognition principles that apply to income tax basis financial statements, and Chapter 6 discusses considerations for financial statements prepared on other bases of accounting.

Presentation

102.3 While transactions are recognized and measured following the applicable financial reporting framework, they generally should be presented in financial statements following GAAP presentation guidelines. That is, assets and liabilities should be presented in the statement of financial position and revenues and expenses (measured in accordance with the applicable financial reporting framework) should be presented in the statement of operations. Furthermore, changes in retained earnings and other components of stockholders' equity generally should be presented following GAAP requirements.⁴ As discussed further in Chapter 3, however, special purpose financial statement disclosures should be similar, but not necessarily identical to, those required by GAAP. Thus, items required to be presented on the face of GAAP financial statements sometimes may be disclosed in the notes to special purpose financial statements so long as the substance of the GAAP information is communicated.

102.4 Since cash basis and income tax basis financial statements do not purport to present financial position and results of operations in accordance with GAAP, they should not be captioned or otherwise referred to as

“Balance Sheet,” “Income Statement,” etc. without appropriate modification. Such titles as “Statement of Assets, Liabilities, and Equity—Cash Basis (or Income Tax Basis),” “Statement of Assets and Liabilities Arising From Cash Transactions,” “Balance Sheet—Modified Cash Basis,” “Statement of Revenues and Expenses—Cash Basis (or Income Tax Basis),” “Statement of Revenues Collected and Expenses Paid,” or other appropriate wording should be used.

102.5 Financial statement form and style considerations are discussed further in Chapter 2, and general presentation issues applicable to the cash, modified cash, and income tax bases are discussed in Chapter 3. Specific presentation issues unique to each special purpose framework are addressed in the respective chapter covering that basis of accounting.

Disclosures

102.6 Financial statements prepared on a special purpose framework require notes and other disclosures. (If the statements are compiled, management may elect to omit substantially all disclosures. However, that option is not available if the statements are reviewed or audited.) The disclosure requirements for special purpose frameworks are not defined in the accounting literature as they are for GAAP, however. Guidance is found in AU-C 800 and SSARS No. 21 and states that the basis of accounting and how it differs from GAAP should be disclosed. AU-C 800 and SSARS No. 21 also point out that when financial statements contain items that are the same as, or similar to, those in GAAP financial statements, the same type and extent of informative disclosure generally is appropriate. The guidance also states that disclosures related to matters that are not specifically identified on the face of the financial statements may be necessary to achieve fair presentation. The explanatory material at AU-C 800.A19-.A23 provides further information about achieving fair presentation through the disclosures in special purpose financial statements and indicates that in some cases, qualitative information could replace the quantitative information required by GAAP. While that explanatory material is not included in SSARS No. 21, the authors believe it could be helpful in considering the fair presentation of disclosures for accountants performing compilation and review engagements.

102.7 Disclosing information in cash, modified cash, and income tax basis financial statements is discussed further in Chapter 3. In addition, disclosure considerations unique to each type of special purpose framework are discussed in the chapter relevant to each basis of accounting (that is, Chapters 4, 5, and 6).

Reporting

102.8 When reporting on special purpose financial statements, certain modifications should be made to the basic reports. The statement titles in the reports should reflect the applicable financial reporting framework statement titles. Audit, review, and compilation reports should disclose the basis of presentation, refer to a note that describes the framework, and include a statement that the framework is a basis of accounting other than GAAP. (Certain exclusions apply to compiled financial statements that omit substantially all disclosures.) Other audit reporting requirements under AU-C 700 and AU-C 800 are discussed in section 702. Other compilation and review reporting requirements under AR-C 80 and AR-C 90, including the exclusions for compiled financial statement that omit substantially all disclosures, are discussed in section 701. Chapter 7 discusses reporting on special purpose financial statements in further detail.

⁴ A statement of cash flows is not required for special purpose financial statements since they do not purport to present financial position and results of operations in accordance with GAAP (see paragraph 204.2). However, an entity that follows either the modified cash basis or income tax basis may choose to present a statement of

cash flows. In addition, because the pure cash method reports all transactions, including purchases of assets and receipts of loan proceeds, as cash receipts or disbursements, the only item that would be present in a pure cash basis statement of financial position would be cash and equity. Thus, the authors recommend presenting a single statement titled “Statement of Cash Receipts and Cash Disbursements” when financial statements are prepared on the pure cash basis.

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