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AN EMPIRICAL INVESTIGATION OF THE ATTITUDES OF MISSISSIPPI CPAS
AND BANKERS CONCERNING SELECTED ASPECTS OF SSARS

Mississippi State University

D.B.A. 1984

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MISSISSIPPI CPAs AND BANKERS CONCERNING
SELECTED ASPECTS OF SSARS

by

Quinton Booker

A Dissertation
Submitted to the Faculty of
Mississippi State University
in Partial Fulfillment of the Requirements for
the Degree of Doctor of Business Administration
in the College of Business and Industry

Mississippi State, Mississippi

August 1984

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1984

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Finally, the author wishes to thank his parents, Mr. and Mrs. Quintin Booker, for their support and encouragement. I dedicate this dissertation to them.

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ABSTRACT

Quinton Booker, Doctor of Business Administration, 1984

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Title of Dissertation: An Empirical Investigation of the
Attitudes of Mississippi CPAs and
Bankers Concerning Selected
Aspects of SSARS

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Abstract

This dissertation provides a more complete understanding of CPAs' and bankers' perceptions of the Statements on Standards for Accounting and Review Services (SSARS), the professional accounting standards that divided unaudited services into compilation and review services.

The confusion among and between many CPAs and bankers regarding the scope of SSARS, and the procedures to be performed in compilation and review services is examined using survey techniques.

A sample of Mississippi CPAs and bank lending officers yielded 95 usable CPA responses and 101 usable banker responses to separate three-page original instruments.

The CPAs' instrument covered practitioners' attitudes concerning SSARS and their frequency of use of selected procedures in compilation and review services. The bankers' instrument covered bankers' attitudes concerning SSARS and their perceptions of the CPA's responsibility to use selected procedures in compilation and review services. Both instruments contained selected inquiry, analytical and audit-type procedures. The CPAs' instrument also contained selected administrative procedures.

In general the CPAs and bankers agreed that SSARS represents a positive development in public accounting practice. However, only one-third of the CPAs agreed that their clients had a better understanding of the services they were obtaining in compilation or review engagements compared to previous "unaudited engagements." Also, over one-third of the bankers agreed that they do not distinguish between compilations and reviews.

The CPAs used inquiry and analytical procedures routinely in compilations and reviews but more frequently in reviews, as would be expected. Although the CPAs rarely used audit-type procedures routinely in compilations, many indicated that they did routinely use such procedures in reviews.

The bankers did not overestimate the CPAs' responsibility to use inquiry and analytical procedures in compilations. Although they placed a greater responsibility on the CPAs to use inquiry and analytical procedures

in reviews, bankers' responses were judged conservative since inquiry and analytical procedures are the cornerstone of a review. The bankers clearly expected selected audit-type confirmation and verification procedures to be performed in compilation and review services, despite the guidance provided by SSARS that such procedures are not routinely contemplated in provision of such services.

The findings led to recommendations of additional continuing education on SSARS for the CPAs and bankers, and for the need of additional research concerning the use of audit-type procedures in review engagements.

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CHAPTER I

INTRODUCTION

During recent years many changes have been made in the professional accounting standards which govern the CPA's association with unaudited financial statements. Old standards that previously applied to all engagements for unaudited statements have been revised and now apply only to public companies; a new set of standards called Statements on Standards for Accounting and Review Services (SSARS) has been created to govern engagements to prepare financial statements for the nonpublic company.

These latter statements, SSARS, allow the CPA to give limited assurance on the financial statements of the nonpublic entity. Such an expression of limited assurance was not allowed before SSARS. This major change, along with other SSARS changes, has led to much controversy in the accounting profession on unaudited standards.

Background Information

For purposes of this study the following definitions apply:

Association with Financial Statements: An accountant is associated with financial statements when he has consented to the use of his name in a report, document, or other written communication containing the statements. Also when an accountant submits to his client or other financial statements that he has prepared or assisted in preparing, he is deemed to be associated even though the accountant does not append his name to the statements.¹

Audited Financial Statements: Financial statements are audited if the accountant has applied auditing procedures sufficient to permit him to report on them, as described in Section 509 of the American Institute of CPAs Professional Auditing Standards.²

Section 509 requires a study and evaluation of internal accounting controls, tests of accounting records, responses to inquiries by obtaining corroborating evidential matter and certain other procedures in connection with an engagement to prepare audited financial statements. Financial statements prepared by the CPA in an engagement not meeting the requirements of Section 509 of the professional standards are usually referred to as "unaudited". The CPA's association with unaudited financial statements has been a problem for the accounting profession for many years. This problem has been attributed to: (1) the common expectation

¹American Institute of Certified Public Accountants Statement on Auditing Standards 26, Association with Financial Statements (New York: AICPA 1979) p. 3.

²Ibid., p. 4.

on the part of many users of unaudited statements that such statements are unaudited but yet "O.K." by virtue of the CPA's association and (2) the lack of knowledge on the part of many users of unaudited statements of the procedures commonly followed by the CPA in the preparation of the statements.

In 1975 Winters reported that a majority of bankers (the major third party users of unaudited statements) attribute increased credibility to unaudited statements as a result of the CPA's association and a majority of bankers also believe that the CPA's association with unaudited statements affords a reasonably high degree of assurance that such statements are not false or misleading.³ In a 1977 study, Bainbridge found that bankers did not fully understand the procedures commonly undertaken in an engagement to prepare unaudited statements; over half of those bankers surveyed were of the opinion that an engagement to prepare unaudited financial statements includes a responsibility by the CPA to evaluate internal controls.⁴

This lack of understanding of the nature of unaudited statements cannot be placed, in total, on the users of the statements; the accounting profession must share in this

³Alan J. Winters, "Bankers Perceptions of Unaudited Financial Statements," The CPA Journal 14 (August 1975) p. 29-33.

⁴D. Raymond Bainbridge, "Unaudited Statements--Bankers' and CPA's Perceptions," The CPA Journal 22 (December 1979) p. 11-17.

lack of understanding because the profession has failed to set sufficiently authoritative guidelines on the minimum procedures to be undertaken in an engagement to prepare unaudited financial statements.

In 1972 Guy and Winters reported that although most CPAs did undertake some limited review procedures in engagements to prepare unaudited financial statements, those procedures varied greatly from firm to firm⁵. Similar findings were reached by Ingram and others on the disclosure practices in unaudited financial statements; although some disclosures were being made, they varied greatly from firm to firm and most disclosure practices were inadequate.⁶

One might ask what has the accounting profession done to bring uniformity to unaudited financial statements and decrease undue reliance? Past efforts were geared toward the identification of unaudited statements (to decrease undue reliance) but little was done to bring uniformity to the procedure to be followed in an engagement to prepare the statements. Professional auditing standards required that unaudited statements be conspicuously marked "UNAUDITED" and that such statements be accompanied by the

⁵Dan M. Guy and Alan J. Winters, "Unaudited Financial Statements: A Survey," The Journal of Accountancy 134 (December 1972) pp. 46-53.

⁶Robert W. Ingram, et al., "Disclosure Practices in Unaudited Financial Statements of Small Businesses," The Journal of Accountancy 144 (August 1977) pp. 81-86.

following disclaimer of opinion:

The accompanying balance sheet of X Company as of December 31, 19__, and the related statements of income and retained earnings and changes in financial position for the year then ended were not audited by us and accordingly we do not express an opinion on them.

Signature

Date

Although the required disclaimer of opinion may have decreased, to some extent, undue reliance on unaudited statements, it also drew strong criticism from the small business community in the latter 60's and early 70's. Many small business owners did not see the need for an annual audit since the entity's shares were closely held. Such an entity would, on occasion, need financial statements with some limited independent review to satisfy creditors, dormant partners, or other stockholders. When the CPA was engaged to examine such an entity's financial statements the engagement, by virtue of professional standards, had to be: (1) an audit with an opinion on the entity's financial position, results of operations, and changes in financial position, or (2) unaudited with no claim of responsibility or degree of assurance (the disclaimer).

This situation placed many small businesses in an awkward situation. On the one hand there was the audit

⁷American Institute of Certified Public Accountants, Codification of Auditing Standards and Procedures (New York: AICPA, 1973), Section 516.04 (originally issued as Statement on Auditing Procedure 38, AICPA, 1967).

model with a price tag too large for many small businesses due in part to a maze of accounting standards; on the other side there was the unaudited model with no claim of assurance or responsibility. In addition to the lack of assurance on the part of the unaudited model, the disclaimer was negative in nature and addressed itself to what the CPA did not do--not what he did do.

Recently, the accounting profession recognized that a major problem existed with the disclaimer as it related to small businesses and that authoritative guidance was needed on engagements to prepare unaudited financial statements. The profession examined the following alternatives to solve the problem: (1) the development of Generally Accepted Accounting Principles (GAAP) specifically for small businesses (These principles would be less complex than the existing GAAP; therefore the cost of an audit for small businesses would be reduced.); and (2) the relaxing of Generally Accepted Auditing Standards when a small business was involved (This would also make the audit model less costly for the small business).

During 1974 the Accounting Standards Division of the American Institute of Certified Public Accountants (AICPA) appointed a task force to study the application of GAAP to small and/or closely held businesses. The task force concluded that accounting measurements should not be affected by the size of the business or the number of shareholders; and therefore, one set of GAAP should be used

by all businesses.⁸ Although the task force did not like the idea of a 'BIG GAAP LITTLE GAAP', they did recommend that the AICPA Auditing Standards Division should reconsider pronouncements concerning the CPA's report on unaudited financial statements of the small and/or closely held business.⁹ This new form of report on the unaudited statement of the small business was finally recognized as the only acceptable method of dealing with the problem at hand while the 1974 appointed Commission on Auditors Responsibility concluded that the same auditing standards should apply to all audits, regardless of the entity's size or the number of shareholders.¹⁰

In response to the call for a new report on the unaudited statement of the small business the AICPA created the Accounting and Review Services Committee (ARSC) in 1975. The Committee studied the matter for more than two years and finally recommended that the profession should offer a lower cost alternative to the opinion audit and that

⁸American Institute of Certified Public Accountants, Report of the Committee on Generally Accepted Accounting Principles for Small and/or Closely Held Businesses (New York: AICPA, 1976).

⁹Ibid., p. 18.

¹⁰American Institute of Certified Public Accountants, The Commission on Auditors' Responsibilities: Report, Conclusions and Recommendations (New York: AICPA, 1978) p. xiii.

standards should be drawn up to cover this new service.¹¹ The committee was given the power to issue these new standards in 1977 when it was elevated to the status of senior technical committee of the AICPA empowered to issue pronouncements in connection with the unaudited financial information of the nonpublic entity. The new statements were designated as Statements on Standards for Accounting and Review Services (SSARS). To date five statements and three interpretations have been issued. SSARS is covered by Rule 204 of the AICPA Code of Professional Conduct. As such, members of the AICPA are required to adhere to the statements or be prepared to justify any departure.

Statements on Standards for Accounting
and Review Services: Major Changes

The introduction of SSARS marked a revolutionary change in the accounting profession to say the least. Statement number one called for: (1) an elimination of the standard disclaimer of opinion for the nonpublic entity; (2) the introduction of two new services for the nonpublic

¹¹Report of the Accounting and Review Services Committee (AICPA: 1977), as cited by William M. Gregory, "Unaudited But OK?" The Journal of Accountancy 145 (February 1978) p. 63.

entity: (A) Compilation (B) Review.¹² The new services are defined as follows:

Compilation of Financial Statements. Presenting in the form of financial statements information that is the representation of management (owners) without undertaking to express any assurance on the statements. (The accountant might consider it necessary to perform other accounting services to enable him to compile financial statements.)¹³

Review of Financial Statements. Performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are not material modifications that should be made to the statements in order for them to be in conformity with Generally Accepted Accounting Principles or, if applicable, with another comprehensive basis of accounting. (The accountant might consider it necessary to compile the financial statements or to perform other accounting services to enable him to perform a review.)¹⁴

After the creation of SSARS, three services existed for the nonpublic entity. An overview of these services appears in Figure 1.

¹²SSARS statements apply only to the nonpublic entity. This clarification will be omitted hereafter. Statements on Auditing standards still provide guidance to the accountant who performs services in connection with the unaudited statements of the public entity. SSARS No. 1 Paragraph 4 defines a nonpublic entity as any entity other than one (a) whose securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, or (b) that makes a filing with a regulatory agency in preparation for the sale of any class of its securities in a public market.

¹³American Institute of Certified Public Accountants Statements on Standards for Accounting and Review Services I. Compilation and Review of Financial Statements (New York: AICPA, 1978), Paragraph 4.

¹⁴Ibid.

Figure 1

Comparison of Audit, Review, and Compilation Services

	Audit	Review	Compilation
Description	An audit involves the critical evaluation of a company's financial statements to form the basis for expressing an opinion on the financial statements taken as a whole. Evidence is gathered through inspection of underlying accounting records and a study and evaluation of internal accounting controls. Observations (e.g., of the inventory taking) and inquiries are made and analytical review procedures are carried out. Confirmations and representations also are obtained. The extent of those procedures depends on the accountant's evaluation of existing facts and circumstances.	A review encompasses performance of inquiry and analytical procedures to provide the accountant with a reasonable basis for expressing limited assurance that there are no material changes that should be made to the financial statements for them to be in conformity with generally accepted accounting principles.	The compilation service consists of presenting information supplied by management in financial format. The compilation does not involve an undertaking to express any assurance on those statements.
What Assurance Can the Accountant Give?	Positive assurance [Generally accepted auditing standards require the accountant to perform procedures necessary to determine if the financial statements are presented fairly in conformity with generally accepted accounting principles, consistently applied. The unqualified audit report states that in the accountant's opinion, based upon this examination, the financial statements are presented fairly.]	Limited--Although the review may bring significant matters affecting your financial statements to the accountant's attention, it does not provide assurance that he will become aware of all significant matters that would be disclosed in an audit.	None--In a compilation, there is no examination or review of financial statements. Quite literally, the accountant compiles information supplied by management into a format appropriate to the company's industry.

Figure 1 (continued)
Comparison of Audit, Review, and Compilation Services

	Audit	Review	Compilation
What Can the Accountant Report?	<p>Financial statements which are audited are accompanied by a report:</p> <ul style="list-style-type: none"> . Stating that an examination was made in accordance with generally accepted auditing standards; . Indicating that the examination included all auditing procedures considered necessary in the circumstances and, ordinarily; . Expressing an opinion whether the financial statements (in all material respects) are presented in accordance with consistently applied generally accepted accounting principles. 	<p>Financial statements which are reviewed are accompanied by a report stating that:</p> <ul style="list-style-type: none"> . A review was performed in accordance with standards established by the AICPA. . All information included in the statements is the representation of management (owners). . A review consists principally of inquiries of company personnel and analytical procedures applied to financial data; . A review is substantially less in scope than an audit, and that no opinion is expressed, and; . The accountant is not aware of any material modifications that should be made to the statements for them to be in conformity with generally accepted accounting principles (other than those modifications, if any, indicated in the report.) 	<p>Financial statements which are compiled without audit or review are accompanied by a report stating that:</p> <ul style="list-style-type: none"> . A compilation has been performed; . A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners); and . The statements have not been audited or reviewed and, accordingly no opinion or any other form of assurance is expressed on them.

Figure 1 (continued)

Comparison of Audit, Review, and Compilation Services

	Audit	Review	Compilation
Sample Report	<p>We have examined the balance sheet of ABC Company as of December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.</p> <p>In our opinion, such financial statements present fairly the financial position of ABC Company at December 31, 19XX, and the results of its operations and the changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.</p>	<p>We have reviewed the accompanying balance sheet of ABC Company as of December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended, in accordance with standards established by the AICPA. All information included in these financial statements is the representation of the management (owners) of ABC Company.</p> <p>A review consists principally of inquiries and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole.</p> <p>Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles. 15</p>	<p>The accompanying balance sheet of ABC Company as of December 31, 19XX, and the related statements of income, retained earnings and changes in financial position for the year then ended have been compiled by us.</p> <p>A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners.) We have not audited or reviewed the accompanying financial statements and, accordingly do not express an opinion or any other form of assurance on them.</p>

¹⁵ Taken from Kenneth J. Dirkes and John R. Deaming, "Audit, Compilation or Review?" The CPA Journal 50 (April 1980) p. 86-87.

Statements on Standards for Accounting and
Review Services: The Controversies

For many years before the creation of SSARS and up to the present the literature has contained numerous articles on the pros and cons of establishing a body like the ARSC for the issuance of formal standards on unaudited financial statements. On the one hand there were those who consider "unaudited standard" to be a major step in the right direction while others held the opposing position.

The view of those who supported the creation of the ARSC and SSARS was best summarized by Wallace E. Olson, past president of the AICPA:

Although SAS 1 Section 516 (the official pronouncement on unaudited statements before SSARS) deals with some aspects of the auditors' association with unaudited financial statements, there is no cohesive body of well-defined standards and procedures that provide guidance on this type of engagement...It is clear that the profession is on notice that the auditors assume some degree of responsibility when they are associated with unaudited statements (in spite of the disclaimer). However, this responsibility is not clearly defined...To deal with this problem the profession should explore various types of reviews designed to provide levels of assurance that fall short of that intended by the opinion audit...This would require the development of a set of procedures and new form of reports designed to fit individual types of engagements.¹⁶

In summary, those who argued for the creation of "unaudited standards" reasoned as follows: (1) Adequate authoritative guidance is lacking on unaudited engagements so

¹⁶Wallace E. Olson, "A Look at the Responsibility Gap," Journal of Accountancy 139 (January 1975) p. 53.

practitioners are doing as they please and placing the disclaimer of opinion on the unaudited statements; (2) Although the disclaimer states that the preparer has not audited the statements and assumes no responsibility for them, such is untrue (Court decisions held that some responsibility was placed on a CPA despite the disclaimer--this is discussed in Chapter 2.); (3) Since some responsibility is assumed in unaudited engagements, standards and appropriate reports should be introduced to reflect the appropriate degree(s) of responsibility--such standards and reports are necessary to protect the practitioner in the case of litigation.

Although SSARS created a new cohesive body of standards and procedures, it has also introduced new problems and uncertainties to the area of unaudited financial statements. These included: (1) the expression of limited assurance in the new review engagements and the possible legal consequences of such; (2) the claim by many that the statements lacked definitive guidance on exactly what procedures should be undertaken in a review engagement; (3) the possible derogatory effect on the professional accountant's status as a result of the recognition of a compilation (mechanical in nature) as a professional accounting service; and (4) the possible down-grading of the professional services received by some small businesses, i.e., the switch from an audit to a review or compilation.

The expression of limited assurance and the possible legal consequences combined with the lack of definitive guidelines on the procedures to be performed in a review engagement represents the major criticism against SSARS to date. Before the issuance of SSARS No. 1, the expression of limited assurance was discouraged in professional accounting literature.¹⁷ SSARS No. 1 requires the expression of limited assurance when the standard short form review report is issued.¹⁸ Some legal experts have claimed that this expression of limited assurance combined with the new services offered may lead to greater legal exposure.¹⁹

In reference to the procedure to be performed in a review engagement, many practitioners look upon SSARS guidance as "gray" to say the least. The problem appears to be the distinction between a review and an audit. One leading practitioner has stated that the review procedures appearing in SSARS 1 read like an audit checklist; and it is very possible that a practitioner, although engaged to perform a review, could be construed to be performing an

¹⁷American Institute of Certified Public Accountants, Guide for Engagements of CPAs to Prepare Unaudited Financial Statements (New York: AICPA, 1975) p. 22.

¹⁸AICPA SSARS 1, Par. 32-35.

¹⁹Dan L. Goldwasser, "Liability Exposure in Compilation and Review," The CPA Journal 51 (September 1980) pp. 27-31.

audit. This could result in damaging legal implications in the event of a liability claim.²⁰

On the matter of the recognition of a compilation as a professional service one leading practitioner has stated:

As a practicing CPA, I find it embarrassing that my national organization has seen fit to even recognize this as a type of professional service. This is comparable to having the secretary in your doctor's office write down certain data on a form and consider it in the category of medical counsel...As a professor in a college, I can attest to the fact that we can train beginning students in accounting to perform the functions of compilation in about four to five weeks.²¹

Other practitioners argued against the recognition of the compilation as a professional service on the grounds that the result is dilution of professional standards which is not good for the CPA.²² Claims such as these, combined with claims by a leading business publication that scores of small businesses planned to eliminate the audit and substitute a less expensive procedure known as a review have led to SSARS being somewhat less than totally accepted by some members of the accounting profession.²³

²⁰Harry G. Brown, "Compilation and Review--A Step Forward?" The CPA Journal 51 (September 1980) pp. 27-31.

²¹Harry G. Brown, "Comments on Compilation and Review (or How the Auditor Doesn't Audit)," Credit and Financial Management 81 (December 1979) p. 10.

²²Charles Chazen, "Compilation of Financial Statements--A Professional Service," The Journal of Accountancy 146 (September 1978) p. 99.

²³Wall Street Journal, 14 May 1979, p. 40.

Statement of the Problem

Two factors have given rise to the problem under study in this research effort. First, it appeared that there was substantial confusion in the financial community concerning the purpose and scope of compilation and review services. This problem manifested itself in that there continued to be a proliferation of articles in the accounting literature regarding practitioner's attitudes on SSARS and the various problems with SSARS.

Second, the literature lacked a sufficient number of studies on bankers' perception of SSARS and, more importantly, bankers' perception of unaudited financial statements since the effective date of SSARS. Since bankers are the major third-party users of unaudited financial statements, their perceptions are important. A knowledge of bankers' perception of SSARS was desired to suggest a need for clarification of SSARS or education of the banking community on SSARS.

In an attempt to determine how bankers and CPAs felt about SSARS and the extent of confusion that existed concerning SSARS, this research surveyed Mississippi CPAs and bankers.

Objective of this Study

The objective of this study was to answer the following questions from CPAs and bankers.

CPAs

1. What is the overall attitude of Mississippi CPAs toward SSARS?
2. What type of procedures are Mississippi CPAs using in the compilation engagement? Are procedures not contemplated by SSARS being used?
3. What type of procedures are Mississippi CPAs using in the review engagement? Are procedures not contemplated by SSARS being used?

Bankers

1. What is the overall attitude of Mississippi bankers toward SSARS?
2. What is the overall perception of Mississippi bankers of compiled statements?
3. What is the overall perception of Mississippi bankers of reviewed statements?

In answering the above questions, this research clarified Mississippi CPAs' and bankers' perceptions of SSARS. The results should prove useful to Mississippi banking groups and CPA groups in evaluating the need for continuing professional education on unaudited financial statements.

Prior Studies

To date, one comprehensive nation-wide empirical study has been completed on SSARS.²⁴ This study was done by Jerry Arnold and Michael Diamond and was exploratory in nature. The research attempted to gauge: (1) actual and

²⁴Jerry L. Arnold and Michael A. Diamond. The Market for Compilation, Review and Audit Services, (New York: AICPA 1981).

projected shifts from audits to reviews or compilations; (2) actual and projected shifts from previous unaudited services to compilations, reviews, or audits; (3) factors which influence the selection of services and the relative cost of each, and (4) lender's and CPA's perceptions on compilations, reviews, and audits. The results were summarized as follows:

Study Results--CPAs

There was a very slight movement (2.5 percent) away from audits to reviews or compilations.

Forty percent of companies that previously had received unaudited disclaimers were receiving some assurance in the form of audits or reviews.

Perceived needs of outside users, the client's system of internal control, and prior experience with the client are the dominant factors influencing CPAs in their recommendations for a given level of service.

For a new client, a compilation requires 20 to 25 percent of the hours required for an audit, and a review requires 49 percent. For a continuing client, a review requires 44 percent of the hours needed for an audit.

Most CPAs feel that the adoption of SSARS 1 represented a positive development by the accounting profession.

The minimum level of service appropriate for business clients is a compilation with disclosures or a review. For personal financial statements a compilation is acceptable.

Study Results--Bankers

Approximately 20 percent of customers furnishing audited financial statements prior to SSARS 1 have moved to reviews or compilations. The difference from the CPA estimate (2.5 percent)

is explained by the experiences of a minority of bankers, who have encountered substantial movement away from audit.

Approximately 8 percent of the customers previously furnishing unaudited financial statements now are audited.

Traditional lending factors, including loan size and the customer's capital structure, have the greatest influence on the banker's decision to require a given level of service. Relative costs of the services are least important.

Bankers tend to feel that introduction of compilation and review services represented a positive development by the accounting profession.

The required level of service increases commensurately with the size and complexity of the loan. For personal financial statements a compilation is most appropriate.²⁵

Need for Additional Study

Three factors may be cited to support the need for this study on SSARS. First, sufficient time has now passed for practitioners to adjust to SSARS and make a fair assessment of any problems which may exist. The Arnold and Diamond Study was conducted immediately after the first year of reporting under SSARS. It was thought that perhaps attitudes changed since that time and/or that practitioners were aware of trouble spots which did not surface during the initial year of reporting under SSARS. The same would apply to bankers. The research allowed sufficient time for the accounting and banking community to adjust to SSARS.

Second, the CPAs and bankers surveyed in the Arnold

²⁵Ibid., p. XIV.

and Diamond Study were selected from relatively large cities (populations in excess of 150,000). One would expect that a change in professional standards such as SSARS would have a great impact on practitioners located in smaller cities since a large percentage of small town practitioners' work is usually "write-up" in nature. Since the Arnold and Diamond study did not deal with the small-town practitioners and bankers, this research did by using a different population (Mississippi CPAs and bankers).

Finally, one of the major recommendations of the Arnold and Diamond Study was a call for continued empirical research on SSARS and its impact on professional accounting practice. This research was designed to help meet this need addressing the issues of the procedures practitioners were commonly using in compilation and review engagements and lender's perception of unaudited statements since the effective data of SSARS.

Methodology

The following paragraph presents a brief overview of the methodology of the study. A detailed presentation is given in Chapter III.

Sampling Plan: CPAs

This research was conducted using Mississippi CPAs residing within the state. Since the subject matter is practical in nature, only those CPAs engaged in public

practice were included in the population. A 1983 Directory of Mississippi Certificate Holders was obtained from the State Board of Public Accountancy. The list contained approximately 2,400 CPAs but lacked sufficient information to identify those CPAs residing within the state engaged in public practice.

In an attempt to identify those CPAs residing within the state engaged in public practice, the 1983-84 yearbook of the Mississippi Society of CPA was obtained. The yearbook contained the information needed to identify most of these CPAs residing within the state involved in public practice. The state society yearbook included approximately 800 Mississippi CPAs residing within the state engaged in public practice. This 800 CPAs served as the population for this study.

Descriptive research typically uses large samples. It has been suggested that descriptive studies should include 10-20 percent of the accessible population.²⁶ This research started with 30 percent of the population (240 Mississippi CPAs) in an attempt to get enough returns to satisfy this 10-20 percent criterion.

Systematic sampling has been cited as a widely used method of sample selection in business and economic

²⁶ Donald Ary, et al., Introduction to Research in Education (New York: Holt, Rinehart and Winston, Inc., 1979) p. 135.

studies.²⁷ This research used systematic selection from The Mississippi Certified Public Accountant--1983-1984 (the state society of CPAs yearbook).

Sampling Plan: Bankers

A group of bank loan officers located throughout the state of Mississippi was surveyed for the second half of this research. In checking with the Mississippi Bankers Association, it was discovered that a detail list of loan officers was not available. Since the state had over 160 parent banks, it was considered impractical to write each bank to obtain such a listing. It was also doubtful that the banks would supply this information. Due to these constraints and the nature of the topic, the bankers selected for this study were not selected at random.

The Mississippi Bankers are divided into eight geographical groups. An executive officer at two parent banks in each geographical group was contacted and asked to participate in the study. Requests continued until at least one parent bank in each region consented to participate and a total of sixteen banks consented to participate. Each executive officer opting to participate in the study was sent a number of banker surveys; he was asked to distribute the survey to loan officers throughout his

²⁷ John R. Stockton and Charles T. Clark, Introduction to Business and Economic Statistics (Cincinnati, Ohio: South Western Publishing Company, 1975), p. 153.

banking system. All surveys were returned directly to the researcher. The above procedure resulted in the participation of approximately 10 percent of the parent banks in the state. This procedure was selected because it was used in the Arnold and Diamond Study mentioned earlier and resulted in a high response rate.

Design of Data Collection Instrument--CPAs

The data collection instrument mailed to the CPAs had four sections. Section I solicited the overall attitude of the sample toward SSARS. A series of closed-end statements about SSARS were made, and the respondents were instructed to select one of five possible answers. A one to five point Likert-type scale ranging from "Strongly Agree" to "Strongly Disagree" was given as possible responses. This system was chosen because Likert-type questions take little time to complete and therefore, the probability of the survey instrument return was increased.

Section II of the survey was designed to find out what practitioners were doing to meet the requirements of SSARS. This information was solicited for Compilation and Review Engagements; Section II-A dealt with the compilation engagement; Section II-B dealt with the review engagement.

In Section II-A the participants were given several administrative procedures mentioned by SSARS (for example, the use of an engagement letter). The participants were asked to indicate the frequency of compliance with each

procedure when engaged to compile financial statements [if the participant was unaware of his firms' policy or had no experience with compiled statements (or reviewed statements covered in Section II-B) he was asked to indicate the frequency with which he thinks he would have used the procedure]. The possible answers ranged from "Always" to "Never" on a one to five point Likert-type scale.

Selected inquiry, review, and audit procedures were also included in Section II-A. The participants were asked to indicate the frequency of use of the procedures when engaged to compile financial statements by using the "Always" to "Never" scale mentioned earlier. The review procedures used consisted of items mentioned by SSARS as possible procedures to be used in a review engagement; the auditing procedures consisted of items mentioned by SSARS as procedures not routinely associated with accounting and review services engagements.

The review and auditing procedures were included in Section II-A because the literature contained claims by practitioners that it is necessary to undertake procedures not contemplated by SSARS to achieve the degree of confidence necessary to issue the reports. Also, the CPA is under a duty to exercise due professional care when engaged to compile financial statements--some have claimed that this has led to the use of review and/or auditing procedures when the CPA is engaged to compile financial statements.

After completing Section II-A (on compilation procedures routinely undertaken) the participants were asked to repeat the Section, answering each question assuming that a review engagement was involved. This constituted Section II-B. The audit procedures included in Section II took on additional meaning in Section II-B since the distinction between a review and an audit appeared not to be clear to many practitioners.

Section III contained selected demographic variables; Section IV was reserved for the participant's comments.

Design of Data Collection Instrument--Bankers

The data collection instrument mailed to the bankers had four sections. Section I was designed to gauge bankers' overall attitude toward SSARS. Questions similar to those used in the CPA's questionnaire Section I were used in the banker's Section I. Some specific questions on bankers' attitudes toward SSARS were added. The same scale used for the CPAs in Section I was used for the bankers in Section I.

Section II of the bankers' questionnaire was designed to solicit bankers' perceptions of the procedures commonly undertaken in a compilation engagement and a review engagement. Section II-A dealt with a compilation engagement; Section II-B dealt with a review engagement. In each section the bankers were given a list of procedures (some commonly associated with unaudited statements and some not

commonly associated with unaudited statements) and were asked to indicate their perception of the extent to which the CPA has a responsibility to perform the given procedure. A one to five point Likert-type scale of "Always" to "Never" was used. Most of those procedures that appeared in the CPA's questionnaire Sections II-A and II-B appeared in the banker's Sections II-A and B.

Selected demographic variables appeared in Section III; Section IV was reserved for comments the bankers wished to make.

Data Analysis

All of the data collected was analyzed using selected programs found in the Statistical Package for the Social Sciences and SPSS Update 7-9.²⁸ Various measures of central tendency and dispersion were examined for each question to achieve the research objective. In addition, the absolute and relative frequencies of the responses were examined to aid in this task.

One Way Analysis of Variance (ANOVA) and the T Test were used to: (1) determine if a difference existed among the CPAs' responses based on selected demographic variables, (2) determine if a difference existed between the CPAs' responses and bankers responses for questions

²⁸C. Hadlai Hull and Norman H. Nie. SPSS Update 7-9 (New York: McGraw Hill, 1981): Norman H. Nie et al., Statistical Package for the Social Sciences, 2nd ed. (New York: McGraw Hill, 1975).

that appeared on both the CPAs' and bankers' questionnaires.

Scope and Limitations

This research addressed SSARS and issues related to SSARS from the standpoint of Mississippi CPAs and bankers. As such, all empirical findings must be restricted to Mississippi. Although broader implications may be drawn from the study, the validation of such implications would require additional study.

The major limitations of the study rest with the sampling plans. The CPAs selected were taken from the State Society. The Mississippi Society of CPAs estimates that approximately 100 to 150 CPAs residing within the state are not members of the State Society of CPAs. As such, their views were not reflected in the findings. This limitation is necessary due to constraints discussed earlier.

Another limitation of the study rests with the selection of the bankers; a random selection of bank loan officers was not possible due to constraints discussed earlier. Although the techniques used insured the selection of participants from each of the eight geographical groups of the Mississippi Bankers' Association, a lack of bias cannot be guaranteed.

Plan of the Dissertation

Chapter One has presented an overview of the entire study including a discussion of the background of the study, statement of the problem, objectives, prior studies, methodology, and scope and limitations.

The second chapter contains a review of the literature on unaudited statements with emphasis on SSARS and a brief overview of official pronouncements on unaudited statements before SSARS.

A detailed description of the methodology is included in Chapter Three. Emphasis is placed on the questionnaire construction, data gathering procedures, and statistical computation to be used.

The fourth chapter is devoted to the findings of the study. An examination of the findings as related to the major research questions is presented for the CPAs and bankers along with comparison between the two groups on attitudes and perceptions.

A summary of the study is presented in Chapter Five. Recommendations and conclusions are also included.

Two appendices are included: (A) The CPA Survey Instrument, and (B) The Bankers' Survey Instrument.

CHAPTER II

A REVIEW OF THE ACCOUNTING LITERATURE ON SELECTED ASPECTS OF UNAUDITED FINANCIAL STATEMENTS

Many factors have contributed to the development (or lack of development) of Unaudited Financial Statements over the years. Factors external and internal to the accounting profession have played an important part. The outcry by the small business community for a low cost alternative to the audit fostered the development of Statements on Standards for Accounting and Review Services (SSARS); however this factor is secondary to the internal problem that plagued the accounting profession for decades--the failure of standard setters to provide objective authoritative guidelines on the preparation of unaudited financial statements. This review of the literature focuses on the profession's most recent attempt to correct this problem by issuing SSARS No. 1 and gives an overview of the situation before SSARS.

The first accounting standard to deal with unaudited financial statements was Statement of Auditing Procedure

(SAP) 23 issued in 1949.¹ This was followed by a small section of SAP 33 (a codification of SAP 1-32) in 1963.² SAP 23 and 33 were directed toward the proper identification of unaudited statements but did not address the issues of the procedures and assurance associated with unaudited statements. Since SAP 23 and 33 are not directly related to the profession's current problems with unaudited statements, they are omitted from this review of the literature.

Unaudited Financial Statements before Statements
on Standards for Accounting and Review
Services: A Historical Overview

During the decade that preceded the initial impetus to create a new body to issue separate standards on the unaudited financial information of the nonpublic entity there were three major factors that contributed significantly to the issuance of SSARS: (1) Statement of Auditing Procedure (SAP) 38, (2) The landmark 1136 Tenants' Corporation V. Max Rothenberg and Company court decision and (3) The Guide For Engagements of CPAs to Prepare Unaudited Financial Statements.

¹American Institute of Accountants, Statement on Auditing Procedure No. 23 (revised), Clarification of Accountant's Report When Opinion is Omitted (New York: AIA: 1949).

²American Institute of Certified Public Accountants Statements on Auditing Procedure No. 33, Auditing Standards and Procedures (New York: AICPA: 1963), Chapter 10, Paragraph 17.

Statement on Auditing Procedure (SAP) No. 38

Statement on Auditing Procedure No. 38 represented the first major attempt by the accounting profession to clarify the independent accountant's obligations when associated with unaudited financial statements.³ The statement addressed the CPA's reporting obligation and, to some extent, the CPA's obligation to verify information contained in the unaudited financial statements.

SAP 38 made it clear that the CPA had an obligation to attach a disclaimer of opinion to unaudited financial statements and to mark each page of the statements as "UNAUDITED". The suggested disclaimer appeared as follows:

The accompanying balance sheet of X company as of December 31, 19..., and the related statements of income and retained earnings and changes in financial position for the year then ended were not audited by us and accordingly we do not express an opinion on them.

(Signature and date)⁴

The disclaimer of opinion required by SAP 38 was by no means new: previous statements had also suggested the use of a similar disclaimer in unaudited engagements.⁵ However, SAP 38 went a step further in that it also stated that the CPA did not have an obligation to apply any

³American Institute of Certified Public Accountants, Codification of Auditing Standards and Procedures (New York: AICPA, 1973), Section 516 (originally issued as Statement on Auditing Procedure 38, AICPA, 1967).

⁴Ibid., Paragraph .04.

⁵AICPA, SAP 33, Chapter 10, Paragraph 17.

auditing procedures to unaudited financial statements.⁶ The pronouncement also stated that the CPA was not expected to have an opinion on compliance with Generally Accepted Accounting Principles in unaudited engagements (however, in the event that the CPA became aware of departures from GAAP, he had an obligation to disclose such departure).⁷

The authoritative guidance of SAP 38 was considered to be sufficient by many members of the profession to meet the needs of the profession. This was the case until the 1136 Tenants' Case caused the profession to rethink its position on unaudited financial statements.

1136 Tenants' Corporation v.
Max Rothenberg and Company

The 1136 Tenants' case served as a landmark court decision in the accounting profession's battle with unaudited financial statements. A synopsis of the case is as follows.⁸

1136 Tenants' Corporation (a cooperative apartment corporation) sued the CPA firm of Max Rothenberg and Company claiming that Rothenberg failed to uncover defalcations committed against 1136 Tenants' by Riker and

⁶AICPA, Codification of Auditing Standards and Procedures, Section 516, Paragraph .02.

⁷Ibid., Paragraph .06.

⁸1136 Tenants' Corporation v. Max Rothenberg and Company, 27 App. Div. 2d 830, 227 N.Y.S. 2d 996 (1967) affirmed. 21 N.Y. 2d 995, 290 N.Y.S. 2d 919, 238 N.E. 2d 322 (N.Y. Ct. App. 1968).

Company (the managers of 1136 Tenants' apartments). Rothenberg was engaged by Riker and Company to perform "accounting services" for the 1136 Tenants' account. Under oral agreement Riker and Company supplied information to the CPA firm on the activities of 1136 Tenants' account; in return, the CPA rendered monthly statements to 1136 Tenants' Corporation. When Riker ran into financial difficulties it was discovered that the information supplied by Riker to the CPAs was incorrect and that Rikers' manager had converted some of 1136 Tenants' funds to his own use. 1136 Tenants' sued the CPAs to recover for the losses caused by this misappropriation.⁹

Although much of the controversy in the case centered on the original intent as to the type of engagement to be performed by the CPAs (audited v. unaudited), it was clear that the CPA firm treated the engagement as unaudited and indicated this in the letter of transmittal that accompanied the statements. The New York Society of CPAs and the American Institute of CPAs agreed with the CPA firm that the evidence clearly indicated that the CPAs were engaged to prepare unaudited financial statements.¹⁰ In spite of the evidence, the lower court and the state

⁹Roger H. Hermanson, et al., Auditing Theory and Practice (Homewood Illinois: Richard D. Irwin, Inc. 1980) pp. 85-86.

¹⁰American Institute of CPAs and The New York State Society of CPAs, "Brief Amicus Curiae on the 1136 Tenants' Case" as printed in the The Journal of Accountancy 133 (November 1971) p. 69.

appeals court held that the CPAs should have detected the defalcations and notified 1136 Tenants' owners. The CPA firm had to pay damages in the amount of \$240,000.

Elliott points out that before the 1136 Tenants' case was settled, very few legal precedents existed on the CPAs' responsibility in connection with Unaudited Financial Statements.¹¹ In handing down the verdict against the CPAs the lower court held that even in engagements to prepare Unaudited Financial Statements the CPA is obligated to perform some auditing procedures (and therefore should have detected Rikers' misappropriations).¹² This position shocked the profession since SAP 38, the authoritative literature on unaudited statements at the time, held that the CPA was not obligated to perform any auditing procedures in unaudited engagements.¹³ Erard interpreted the 1136 Tenants' decision as an indication that practitioners could no longer prepare unaudited financial statements without running the risk of litigation for not detecting errors that should have been detected in an audit.¹⁴ The AICPA felt that the 1136 Tenants' decision would serve as a barrier to prohibit many practitioners from preparing

¹¹Norman J. Elliott, "Another View of the 1136 Tenants' Case," The CPA Journal 42 (December 1972) p. 1001.

¹²AICPA, and NYSS CPAs "Brief Amicus Curiae," p. 69.

¹³AICPA, Codification of Auditing Standards and Procedures, Section 516, Paragraph .02.

¹⁴I. C. Erard, "Unaudited Financial Statements," Management Accounting 57 (August 1975) p. 48.

unaudited statements.¹⁵ Since the appeals court failed to reverse the lower court's decision, there was a need in the profession for additional guidance in the area of unaudited financial statements; this new guidance was provided when The American Institute of CPAs published a Guide for the Engagement of CPAs to Prepare Unaudited Financial Statements.

Guide for Engagement of CPAs to Prepare Unaudited Financial Statements

The AICPA published the Guide for Engagement of CPAs to Prepare Unaudited Financial Statements (The guide) to give additional guidance to CPAs engaged to prepare unaudited financial statements.¹⁶ The guide did not replace SAP 38, but was to be used in conjunction with it.

One might ask why the guide was necessary in light of the existing pronouncement on unaudited statements? After the 1136 Tenants' decision two separate and distinct schools of thought developed on the procedures that should be undertaken in unaudited engagements, despite the SAP 38 claim that the CPA did not have a responsibility to apply any auditing procedures in engagements to prepare unaudited financial statements. The schools are described by Guy and Winters:

¹⁵AICPAs and NYSS CPAs, "Brief Amicus Curiae," p. 73.

¹⁶American Institute of Certified Public Accountants Guide for Engagement of CPAs to Prepare Unaudited Financial Statements (New York: AICPA, 1975).

One school advocates that no review procedures for unaudited statements should be employed at all since the use of such guidelines might give the indication that an audit, however limited, was performed. Members of this school wish to avoid the risk of giving such an indication to a judge or jury should legal action be involved later... The second school takes the position that minimum review procedures, again not necessarily auditing procedures, are essential when the accountant is associated with unaudited financial statements... This belief is founded on the premise that review procedures are necessary both to provide the client with a satisfactory level of service and to guard against becoming¹⁷ associated with substandard financial statements.

The guide took a somewhat wavering position on the procedures to be performed stating that the CPA did not have a responsibility to perform any auditing procedures in an unaudited engagement but, due to the requirement that the CPA is under a duty to exercise due professional care, it might be necessary for the CPA firm to perform additional procedures in unaudited engagements if circumstances dictate a need for such procedures (as a result of suspicious circumstances).¹⁸ In addition, the guide provided guidance to practitioners on other aspects of unaudited engagements. For example, the engagement letter was strongly recommended to avoid any misunderstandings on the scope of the unaudited engagement.¹⁹

¹⁷ Dan M. Guy and Alan J. Winters, "Unaudited Financial Statements: A Survey," The Journal of Accountancy 134 (December 1972) p. 51.

¹⁸ The Guide Chapter 2.

¹⁹ Ibid.

Although the guide was viewed by many as an improvement over SAP 38 alone, it also created what Gregory called a "Catch 22" situation in the profession, i.e., the CPA had no obligation to perform any procedures in unaudited engagements but could be accused of failing to exercise due professional care in the event that he did not perform any procedures.²⁰

Statements on Standards for Accounting and
Review Services: Relief for the CPA?

In spite of the additional guidance provided by the guide, engagements to prepare unaudited financial statements remained a somewhat controversial topic. The problem lingered on exactly what type of procedures to use and how many procedures to use; although the legal counsel for some major accounting firms advised their clients not to apply any review procedures in engagements to prepare unaudited statements, studies showed that the majority of practitioners continued to apply some minimum review procedures, and in some instances, they used auditing procedures.²¹

In an attempt to finally resolve the issue, the AICPA created the Accounting and Review Services Committee (ARSC) to issue new standards to cover the unaudited financial

²⁰William R. Gregory, "Unaudited But OK?," The Journal of Accountancy 145 (February 1978) p. 62.

²¹Dan M. Guy and Alan J. Winters, "Unaudited Financial Statements: a Survey," p. 51.

statements of the nonpublic entity. Statements on Standards for Accounting and Review Services divided the traditional unaudited financial statements into two separate categories: compiled statements (prepared without the use of any review or auditing procedures--therefore similar to the "old" unaudited statements) and reviewed statements (prepared with the use of limited review procedures--a new type of unaudited engagement.)²²

Did SSARS finally solve the unaudited problem? In late 1980 Perry stated:

"no one anticipated the host of problems that would follow in the wake of SSARS No. 1...which was generally accepted as a major step in tackling the growing problem of liability exposure resulting from the preparation of unaudited financial statements."²³

Indeed, a variety of problems have been cited by practitioners on the compilation and review of financial statements. Perceptions of the compilation and the review are discussed next; an overview of each engagement is presented before each discussion.

The Compilation Engagement: Practitioners' Perceptions

The compilation engagement is characterized by the presentation in the form of financial statements of

²²American Institute of Certified Public Accountants Codification of Statements on Standards for Accounting and Review Services Numbers 1 to 5 (New York: AICPA, 1983).

²³Larry L. Perry, "Pitfalls that Practitioners are Encountering in Compilation and Review Engagements," The Practical Accountant 13 (December 1980) p. 17.

information that is the representation of management without undertaking to express any assurance on the statements.²⁴ The CPA is not required to make any inquiries or perform any procedures to verify, corroborate or review the information supplied by the entity. To compile financial statements, the CPA should have an understanding of both the industry within which the entity is operating and the nature of the entity's business operations. In addition, the CPA must read the financial statements and consider whether they are free from "obvious material errors"; in the event that the statements lack adequate disclosures, this must be mentioned in the compilation report.²⁵

CPAs have continually expressed concern on several aspects of the compilation engagement. These include: (1) the legal consequences of the engagement, (2) the mandate by SSARS that the CPA is to police "obvious material errors" and disclosures in a compilation and (3) the nonprofessional nature of the compilation engagement.

Legal Consequences. The risk of being sued is inherent in the practice of public accounting. One of the major purposes of accounting standards is to minimize this threat

²⁴AICPA, Codification of SSARS Numbers 1 to 5, Section 100, paragraph .04.

²⁵Ibid., paragraphs .09-13.

of litigation through the establishment of objective standards that clarify the practitioners' responsibility in the various types of engagements (audit, review, or compilation). This is especially true in a compilation engagement since the CPA does not express any assurance. Does SSARS' compilation standards minimize the CPA's legal exposure? Although it is too early at this time to objectively determine the legal ramifications of the compilation, some CPAs have expressed concern about the possibility of an increase in the CPA's legal exposure in the compilation engagement as compared to the old unaudited engagement.

One major source of litigation on unaudited statements has been the third party user of the statements. Such claims have usually resulted from undue reliance on the statements by the third party. Kenneth Solomon, Charles Chazen and Richard Miller claim that undue reliance may very well be a problem with the compilation engagement due to the "expectation gap."²⁶

Solomon, Chazen and Miller contend that there is an expectation on the part of the third party users of unaudited financial statements that the statements are fair and accurate due to the CPA's association. These expectations exceed those warranted by the CPA. This problem is com-

²⁶Kenneth Solomon, et al., "Compilation and Review: The Safety Factor," The Journal of Accountancy 156 (July 1983) p. 50.

pounded in a compilation since the CPA must now issue an official report on the statements and official accounting standards now exist to cover the engagement. The result is a great amount of legal exposure in the compilation due to unwarranted expectations in spite of SSARS' attempt to minimize this exposure. The authors point out that this undue reliance will be present regardless of the wording of the compilation report due to the CPA's association and the existence of professional compilation standards. They conclude that the expectation gap may be unbridgeable; since CPAs do not have the same perception of a compilation, it cannot be expected that a third party user of the statements will understand the scope of the engagement.²⁷

The claim that an expectation gap exists between the preparer and the users of unaudited financial statements is by no means new. Chazen and Solomon advanced the same argument some ten years before the issuance of SSARS and creation of the compilation engagement.²⁸ The claim now, however, is that SSARS' compilation engagement makes the gap wider since the CPA is dealing with an "official" professional service which is slightly narrower in scope than the previous unaudited statements.

²⁷ Ibid., pp. 52-54.

²⁸ Charles Chazen and Kenneth Solomon, "The Unaudited State of Affairs," The Journal of Accountancy 134 (December 1972) p. 41.

Several court decisions are cited by Solomon, Chazen and Miller to suggest that the courts may uphold undue reliance on compiled statements by a third party. In *Blakely v. Lisac*²⁹ the courts held that the CPA has a duty to undertake at least a minimal investigation into the figures supplied to him even in unaudited write-up work. In *Spherex, Inc. v. Alexander Grant and Company* (1982) the court held that it is not unreasonable for a third party to rely on unaudited financial statements in spite of the presence of a disclaimer of opinion.³⁰

Some members of the accounting profession do not accept the expectation gap argument. Robert D. Miller, a past member of the AICPA Accounting and Review Services Committee, points out that SSARS mandates that the CPA must establish an understanding with the client, preferably in writing, regarding the nature and scope of compilation services³¹--this should minimize undue reliance by the client. Also, a compilation report covering the scope of the engagement must be attached to the compiled statements--this should minimize the risk of undue reliance by a

²⁹*Blakely v. Lisac*, 357 Fed. Supp. 255 (D. Ore. 1972), as reported by Kenneth Solomon, et al. "Compilation and Review: The Safety Factor," p. 52.

³⁰*Spherex Incorporated v. Alexander Grant and Company*, 451 A 2d. 1308 (N.H. Supreme Court 1982), as reported by Kenneth Solomon, et al., "Compilation and Review: The Safety Factor," p. 52.

³¹AICPA Codification of SSARS Numbers 1 to 5, Section 100, paragraph .08.

third party.³² Miller points out that the compilation standards set by SSARS are objective and clearly worded: in the event that undue reliance is placed on compiled statements by a third party, the CPA should not have a problem proving this in court.³³

Dan L. Goldwasser, an attorney with a law firm which serves as legal counsel to the professional liability insurance committee of the New York Society of CPAs, states that SSARS may result in greater legal exposure for the CPA--but, this is due to the greater precision of the standards as compared with previous standards. If the CPA follows the standards, Goldwasser is convinced the greater legal exposure should not exist.³⁴

In his analysis of the issue of the CPA's legal exposure in a compilation, Perry takes the position that the CPA's legal exposure is increased beyond that level that existed in pre-SSARS days.³⁵ A study by Sepp³⁶ and a

³²Robert D. Miller, "Compilation and Review: Standards' Impact on Risk," The Journal of Accountancy 156 (July 1983) p. 60.

³³Ibid., p. 66.

³⁴Dan L. Goldwasser, "Liability Exposure in Compilation and Review," The CPA Journal 51 (September 1980) p. 31.

³⁵Larry L. Perry, "Pitfalls that Practitioners are Encountering in Compilation and Review Engagements," p. 26.

³⁶Paul Sepp, "How Accountants Feel About Compilation and Review Services," The Practical Accountant 13 (December 1980) p. 20.

study by Page³⁷ indicated that a large number of practitioners are concerned that the compilation engagement may result in greater legal exposure than the previous unaudited statements. However, in both studies, those who held this view were in the minority.

"Obvious Material Errors" and Adequate Disclosures.

SSARS No. 1 states the following in reference to a compilation engagement:

Before issuing his report, the accountant should read the compiled financial statements and consider whether such financial statements appear to be appropriate in form and free from obvious material errors. In this context, the term error refers to mistakes in the compilation of the financial statements, including arithmetical or clerical mistakes, and mistakes in the application of accounting principles, including inadequate disclosures.³⁸

This section of the compilation standards has been heavily criticized by practitioners because the CPA is charged to police the application of accounting principles and disclosures in an engagement in which inquiries and the performance of review and auditing procedures are not required.³⁹ On this matter, Larry Perry states that the discovery of a mistake in the application of accounting principles is not an "obvious" material error (despite SSARS use of this as

³⁷R. Frank Page, "Local Practitioners Respond to Compilation and Review," The National Public Accountant 25 (October 1980) p. 31.

³⁸AICPA, Codification of SSARS Numbers 1 to 5, Section 100, Paragraph 13.

³⁹Ibid., Paragraph 12.

an example in the compilation standards): to uncover mistakes in the application of accounting principles will take procedures not contemplated by the SSARS' compilation standards. Perry also contends that this mandate may be a source of great legal exposure to the practitioner.⁴⁰

A similar view is held by Harry G. Brown, practitioner and professor. Brown claims that the discovery of these obvious material errors requires transaction analysis which is not contemplated in a compilation engagement.⁴¹

Before the issuance of SSARS some CPAs complained of a "Catch 22" situation with unaudited financial statements, i.e., the practitioner ran the risk of being held to an audit standard regarding the detection of errors if he performed additional procedures in the engagement; yet, if he elected not to perform any procedures in the engagement he may have been found guilty of the failure to exercise due professional care.⁴² It appears that the obvious material error section of the compilation standards did little to help this situation.

A similar situation exists on the disclosures in compiled statements. Compiled statements must contain adequate disclosures or a statement in the compilation

⁴⁰Larry L. Perry, "Pitfalls that Practitioners are Encountering in Compilation and Review," p. 19.

⁴¹Harry G. Brown, "Compilation and Review--A Step Forward," The CPA Journal 22 (May 1979) p. 21.

⁴²William R. Gregory, "Unaudited but OK?", p. 62.

report that the disclosures are limited or omitted.⁴³ How can the CPA vouch for disclosures in a compilation since inquiry and the use of review and auditing procedures are not required? More importantly, how will the legal system treat a liability claim against the CPA by a third party if the claim is based on misleading compiled financial statements due to a lack of disclosures? Solomon, Chazen and Miller contend that there is a strong possibility that the CPA may be held liable to the third party because the statements were misleading due to the absence of the disclosures and the CPA had knowledge of this fact.⁴⁴ Goldwasser arrived at a similar conclusion when he examined the issue.⁴⁵ Due to this, it has been suggested that the CPA should decline compilation engagements if management elects to limit or omit footnote disclosures unless the CPA is very familiar with the client and knows of his stable financial position.⁴⁶

Is it Professional? Some members of the accounting profession have spoken against the recognition of the compilation as a professional accounting service offered by

⁴³AICPA, Codification of SSARS Numbers 1 to 5, Section 100, Paragraphs 13 and 19.

⁴⁴Kenneth Solomon, et al., "Compilation and Review: The Safety Factor," p. 56.

⁴⁵Dan L. Goldwasser, "Liability Exposure in Compilation and Review," p. 29.

⁴⁶Kenneth Solomon, et al., "Compilation and Review: The Safety Factor," p.56.

CPAs. Charles Chazen, for example, states "I oppose the concept of encouraging CPA's to issue reports after performing only compilation--In my opinion, this lowers our professional standards...and places blots on our professional image."⁴⁷ He goes on to say that the basic concept of compilation will result in misleading the public in that some clients will obtain the service just to make use of the CPA's letterhead and therefore make the financial statements appear to have some degree of credibility.⁴⁸

On this same issue, Harry Brown contends that the accounting profession is attempting to sell an old product by renaming it and issuing lengthy reports.⁴⁹ He also points out that beginning students in accounting can be taught to compile financial statements in four to five weeks.⁵⁰ Brown concludes that he is embarrassed that his national organization has seen fit to recognize a compilation as a professional accounting service.⁵¹

⁴⁷Charles Chazen, "Compilation of Financial Statements--A Professional Service," The Journal of Accountancy 146 (September 1978) p. 99.

⁴⁸Ibid.

⁴⁹Harry G. Brown, "Comments on Compilation and Review (or how the Auditor Doesn't Audit)," Credit and Financial Management 81 (December 1979) p. 10.

⁵⁰Ibid.

⁵¹Ibid.

Members of the AICPA staff have attempted to justify the compilation on the grounds that many small companies do not have an accounting staff to prepare financial statements, therefore the CPA should fill the void by offering compilation services.⁵² Chazen counters this argument by point out that SSARS does not prohibit an outside CPA from accepting a compilation engagement when the client has the capability of having the statements prepared internally.⁵³

The Review Engagement: Practitioners' Perceptions

The review engagement is defined as:

"performing inquiry and analytical procedures that provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles or, if applicable,⁵⁴ with another comprehensive basis of accounting".⁵⁴

The review differs from the compilation in that inquiry and analytical procedures are used in a review to express limited assurance on the financial statements: no expression of assurance is contemplated in a compilation.⁵⁵

⁵²William R. Gregory and Thomas P. Kelly, "Compilation, Review, and the Division of CPA Firms--Their Impact on the Small Business Customer and His Banker," The Journal of Commercial Bank Lending 61 (August 1979) p. 2.

⁵³Charles Chazen, "Compilation and Review of Financial Statements--A Professional Service," p. 99.

⁵⁴AICPA, Codification of SSARS Numbers 1 to 5, Section 100, Paragraph .04.

⁵⁵Ibid.

To review financial statements the CPA must: (1) understand the accounting principles and practices of the industry in which the client operates and (2) understand the client's business, including its operating characteristics, nature of its assets, liabilities, revenues and expenses.⁵⁶ The CPA is not required to study and evaluate internal controls, test accounting records or gather evidence from outside parties through confirmations in a review. However, should the CPA become aware that certain information coming to his attention is incorrect, incomplete or unsatisfactory, he should perform any additional procedures needed to achieve the limited assurance contemplated by the review.⁵⁷

Overall, the review engagement has drawn stronger criticism from practitioners than the compilation. The creation of a new level of assurance has led to much controversy. In addition, the legal ramifications of the review and claims of reporting problems in a review have led to much criticism.

Limited Assurance. In regard to reports on unaudited financial statements, the guide stated the following:

Different wording (is) to be avoided. The recommended disclaimer is intentionally brief. Attempts to find substitutes for the recommended simple language--or attempts to expand the report

⁵⁶Ibid., Paragraphs .23-26.

⁵⁷Ibid., Paragraph 29.

unnecessarily--frequently results in report language that is technically inaccurate and likely to mislead readers. For instance, using an expression such as 'without complete audit verification' or 'this examination performed was not in accordance with generally accepted auditing standards' implies that some type of audit was performed and the CPA may find he⁵⁸ has assumed more responsibility than he intended.

SSARS suspended the guide's standards and sanctioned limited assurance in the review engagement.⁵⁹ This reversal of position on limited assurance shocked some practitioners: Gregory states that the very suggestion that the CPA express limited assurance was considered heresy before SSARS.⁶⁰

Harry Brown contends that the profession should have kept the guide's standards and not allowed the expression of limited assurance.⁶¹ He points out that the review report is longer than the unqualified audit opinion and appears very impressive--the results will be a confused public and greater legal exposure for the CPA. He also states that as a partner in an accounting firm he is delighted when his clients understand the difference between audited and unaudited--the creation of different

⁵⁸AICPA, Guide for Engagements of CPAs to Prepare Unaudited Financial Statements, p. 22.

⁵⁹AICPA, Codification of SSARS Numbers 1 to 5, Section 100 Paragraphs 32-41.

⁶⁰Wm. R. Gregory, "Unaudited But OK?" p. 61.

⁶¹Harry G. Brown, "Compilation and Review--A Step Forward," p. 20.

types of unaudited statements was not feasible and did not simplify past problems with unaudited statements.⁶²

One might ask why did the AICPA change its position on limited assurance? First, the Accounting and Review Services Committee saw a need for a low-cost alternative to the audit model to serve the needs of the small business community. Second, the Committee recognized that different levels of unaudited assurance actually existed in practice, therefore a new reporting alternative was needed to distinguish between the two extremes of unaudited statements.⁶³ Many members of the profession have expressed strong support for limited assurance based on the Accounting and Review Services Committee ARSC rationale.⁶⁴

Legal Consequences. What are the legal consequences of the review engagement? Although the service has not been in existence long enough to objectively answer this question, many practitioners have extrapolated from past legal situations with unaudited statements and decided that the CPA will definitely be exposed to a high risk of litigation in the review. This risk appears to be a factor

⁶²Ibid., p. 23.

⁶³See Wm. R. Gregory, "Unaudited but OK?" p. 63 and Earle V. King and Joseph T. Cote, "Compilation and Review," California CPA Quarterly 47 (June 1979) p. 9.

⁶⁴See for example William R. Gregory and Thomas P. Kelly, "Compilation, Review, and the Division of CPA Firms--Their Impact on the Small Business Customer and his Bank," p. 8.

in the expression of limited assurance and the very nature of SSARS' review standards.

Sandra K. Miller contends that in spite of SSARS No. 1 attempt to clarify the CPA's responsibility in the review engagement, the statement is ambiguous and confusing.⁶⁵ Miller points out that the contract between the CPA and the client is unclear due a lack of objectivity in defining limited assurance. She feels that the mandate in the review standards that requires the CPA to "perform additional procedures"⁶⁶ in the event that he becomes aware of false or misleading information is too vague and open ended since the standards do not indicate the nature of the additional procedures. Miller concludes that this "catch-all" requirement may easily lead to very high legal exposure in the review engagement.⁶⁷

Solomon, Chazen and Miller state that the major threat of litigation in the review engagement comes from the review standards' statement that the inquiries to be performed are a matter of the CPA's judgement. They point out that the judgement of two accountants may differ on the procedures to be performed--this may very well be the case

⁶⁵Sandra K. Miller, "The Scope of Accountants' Legal Liability under SSARS #1 Remains Unclear," The National Public Accountant 24 (October 1979) p. 19.

⁶⁶AICPA Codification of SSARS Numbers 1 to 5, Section 100, Paragraph 29.

⁶⁷Sandra K. Miller, "The Scope of Accountants' Legal Liability Under SSARS #1 Remains Unclear," p. 19.

when one accountant is a plaintiff's expert witness with hindsight and the other is the defendant without the benefits of hindsight.⁶⁸ They also contend that it is doubtful that users of reviewed statements will calibrate the difference between reviewed statements and audited statements. Since semi-reliable CPA-prepared statements do not exist in the minds of the users, undue reliance is eminent. The results may be high legal exposure for the CPA in the review engagement.⁶⁹

Brown contends that it is difficult to objectively determine when the practitioner has done enough work to satisfy the review's limited assurance requirements. This is due to the gray area which exists between a review and an audit. To perform too many procedures may indicate to a court that an audit was performed, regardless of the engagement--yet not to perform enough procedures may also result in a claim of negligence. The review engagement puts the practitioner in an awkward position from the standpoint of legal exposure.⁷⁰

Perry has also examined the review requirement that the CPA must achieve limited assurance on the reviewed statements by inquiry and analytical procedures plus any

⁶⁸Kenneth Ira Solomon, et al., "Compilation and Review: The Safety Factor," p. 54.

⁶⁹Ibid., p. 55.

⁷⁰Harry G. Brown, "Compilation and Review--A Step Forward?" p. 21.

additional procedures deemed necessary in the circumstances.⁷¹ He concluded that in some instances audit type procedures will be necessary in a review. In such a case, he cautions the practitioner to document the engagement very carefully as a review and avoid the use of the word "audit" in all aspects of the engagement, especially in communications to outside parties (for example, receivable confirmation).⁷² Perry still insists that the creation of the review has increased the CPA's liability exposure in connection with unaudited financial statements now as compared with the pre-SSARS years.⁷³

A survey by Sepp and another by Page revealed that practitioners are very concerned over the legal consequences of the review engagement. Sepp reported that a majority of the members of the Montana Society of CPAs felt that the practitioner's legal liability is greater in a review engagement than with the previous unaudited engagement.⁷⁴ Page reported that many practitioners feel that the scope of the review engagement may be misunderstood by users of reviewed statements and a concentrated effort to

⁷¹Larry L. Perry, "Pitfalls that Practitioners are Encountering in Compilation and Review Engagements," p. 23.

⁷²Ibid., p. 26.

⁷³Ibid.

⁷⁴Paul Sepp, "How Accountants Feel About Compilation and Review Services," The Practical Accountant 13 (December 1980) p. 20.

clear up such confusion would not help the situation due to the subjective nature of the engagement.⁷⁵

In summary it appears that practitioners are very uneasy over the legal consequences of the review due primarily to the subjective nature of limited assurance. Robert Miller, Vice-President-Local Practice Activities at the AICPA, contends that the review standards set by SSARS must be subjective since each engagement will differ based on the circumstances.⁷⁶ This subjectivity has led to a wide array of procedures in the review engagement.

Derstine and Brewer reported that some practitioners routinely use audit-type procedures in the review engagement and do not rely heavily on the analytical procedures called for by the review standards.⁷⁷ They point out that this is the same problem that prompted the SSARS dichotomy--a revisit of the problem seems apparent.⁷⁸

Reporting Problems. Some discussion has surfaced regarding the appropriate course of action to be taken by the CPA when significant departures from GAAP exist in a

⁷⁵Frank Page, "Local Practitioners Respond to Compilation and Review," The National Public Accountant 25 (October 1980) p. 30.

⁷⁶Robert D. Miller, "Compilation and Review," p. 68.

⁷⁷Robert P. Derstine and Wayne G. Bremer, "SSARS Review: What are Practitioners Doing?" The Journal of Accountancy 155 (April 1983) p. 28.

⁷⁸Ibid., p. 36.

review engagement or the CPA is unable to achieve the limited assurance contemplated in the engagement.

In the case of the departures from GAAP, SSARS states that the CPA may modify his report to disclose the departures⁷⁹, withdraw from the engagement⁸⁰, or disclose the departures in a separate paragraph and add a paragraph to the review report stating that the departures from GAAP may exert a significant impact on the overall fairness of the financial statements.⁸¹ The adverse opinion (as found in reports on audited financial statements) is not allowed in review reporting.⁸² Also, in the event that the CPA is not able to achieve limited assurance, the disclaimer (as found in reports on audited financial statements) is not allowed--the CPA may attempt to issue a compilation report or withdraw from the engagement if limited assurance cannot be acquired.⁸³

Louis G. Gutberlet, past member of the ARSC, qualified his assent to the issuance of SSARS No. 1 since the adverse opinion is not allowed in the case of significant departures from GAAP. Gutberlet believes that the adverse

⁷⁹AICPA, Codification of SSARS Numbers 1 to 5, Section 100, Paragraph 39.

⁸⁰Ibid., Paragrah 41.

⁸¹Ibid., Paragrah 40.

⁸²Ibid., Section 9100, Paragraph 24.

⁸³Ibid., Section 100, Paragraph 36.

opinion is a necessity in the case of significant departures from GAAP.⁸⁴ Robert E. Rossel, also a past member of the ARSC, felt that SSARS No. 1 contained inadequate guidance on when the CPA should withdraw from the engagement or modify his report since the adverse opinion was not allowed.⁸⁵ Since the time of issuance of SSARS No. 1 some additional guidance has been provided on how the CPA should handle significant departures from GAAP. However, the adverse opinion is still not allowed.⁸⁶

Mr. Gutherlet also objected to the guidance by SSARS that the CPA may issue a compilation report in the event that he is unable to acquire limited assurance in the review engagement. He contends that the initial terms of the engagement should dictate the type of report to be issued, and the issuance of a compilation report is inappropriate when the initial term of the engagement was for a review--the disclaimer should be issued when the CPA is unable to achieve limited assurance.⁸⁷

Dan Goldwasser points out that the lack of flexibility in review reporting may result in litigation between the

⁸⁴AICPA, Statement on Standards for Accounting and Review Services Number 1: Compilation and Review of Financial Statements (New York: AICPA, 1979) p. 30.

⁸⁵Ibid., p. 29.

⁸⁶AICPA, Codification of SSARS Numbers 1 to 5, Section 9100, Paragraphs 18-22.

⁸⁷AICPA, SSARS Number 1, p. 30

CPA and the client regarding fee collection in the event that the CPA is unable to issue any type of report and must withdraw from a review engagement. He contends that it may be difficult for the CPA to collect on an engagement in which no report is rendered in spite of the fact that the CPA has satisfied the terms of the contract and is entitled to the fee. Goldwasser concludes that the CPA should be very careful not to accept a review engagement in which there is a high probability that the client's accounting system or other matters might preclude the CPA from issuing a review report, since a disclaimer opinion is not allowed.⁸⁸

Statements on Standards for Accounting and
Review Services: Bankers' Perceptions

Bankers have frequently been cited as the major third party users of unaudited financial statements.⁸⁹ Such statements are used by bankers in the credit granting process for small businesses and, in some instances, for personal loans. As such, bankers' perceptions of unaudited financial statements are important. Also, due to this heavy reliance on unaudited financial statements, bankers might serve as a major third party source of litigation involving unaudited statements.

⁸⁸Dan L. Goldwasser, "Liability Exposure in Compilation and Review," p. 31.

⁸⁹For example see Alan J. Winters, "Bankers Perceptions of Unaudited Financial Statements," The CPA Journal 14 (August 1975) p. 29.

Pre-SSARS days contained numerous accounts of the lack of total understanding on the part of the banking community on unaudited financial statements.⁹⁰ Such a lack of understanding may have been justified since unaudited financial statements lacked uniformity at that time.⁹¹ Since SSARS exists now, one might ask what are bankers' preceptions of unaudited statements today? A review of the literature on this question follows.

Bankers' Acceptance of SSARS

Members of the banking community have expressed mixed feelings on the issuances of SSARS by the ARSC. Robert Morris Associates (RMA), the national association of bank loan and credit officers, voiced stiff opposition to the compilation standards set by SSARS.⁹² The association claimed that the use of the CPAs' letterhead for compiled financial statements or for the compilation report would result in undue reliance on the statements, regardless of

⁹⁰See D. Raymond Bainbridge, "Unaudited Financial Statements--Bankers' and CPAs' Perceptions," The CPA Journal 22 (December 1979) p. 11. or Alan J. Winters, "Bankers' Perceptions of Unaudited Financial Statements," p. 29.

⁹¹Dan M. Guy and Alan J. Winters, "Unaudited Financial Statements: A Survey," The Journal of Accountancy 134 (December 1972) p. 46.

⁹²Robert Morris Associates Comments on SSARS No. 1 Exposure Draft as cited by James R. Waterston, "Compilation, Review and the Division of CPA Firms--a Banker's Perspective," The Journal of Commercial Bank Lending 61 (August 1979) p. 12.

the wording of the compilation report. They suggested that the accounting profession would be better off by not reporting to third party users under the compilation method and that financial statements compiled by the CPA should appear on plain paper.⁹³

Concern was also expressed by RMA regarding the possible pressure by lenders' clients to down-grade accounting services from audits to reviews or compilations to save money. The association cautioned its members against granting such requests and concluded that attempts should be made to upgrade services if at all possible.⁹⁴

James R. Waterston, senior vice-president of Detroit Bank and Trust Company, has also expressed concern similar to that of RMA.⁹⁵ Waterston contends that the compilation is unprofessional and misleading and that bankers are still unable to ascertain the amount of work performed or the amount of assurance provided in a review engagement, despite AICPA claims to the contrary before the issuance of SSARS.⁹⁶ He also points out that the establishment of

⁹³Ibid.

⁹⁴Edwin A. Schoenborn's Letter to the Members of Robert Morris Associates, July 1979, as cited by Jerry L. Arnold and Michael A. Diamond in The Market for Compilation, Review, and Audit Services (New York: AICPA 1981) p. 49.

⁹⁵James R. Waterston, "Compilation, Review and the Division of CPA Firms," p. 11.

⁹⁶Ibid., p. 14.

double standards in accounting and auditing (public company standards v. nonpublic company standards) only confuses the users of the statements and will lead to a lack of confidence in the accounting profession.⁹⁷ Thomas L. Stitchberry a vice-president of the First Pennsylvania Bank, has also expressed views similar to Waterston.⁹⁸ Stitchberry contends that bankers still have no way of determining exactly how much reliance can be placed on a review (due to the subjective nature of the service), therefore "he is in almost the same position as he found himself with the (old) unaudited statements."⁹⁹

Not all of the reaction to SSARS from the banking community has been negative. A national study by Arnold and Diamond concluded that bankers, in the aggregate, view SSARS as a positive development in the accounting profession.¹⁰⁰ Stitchberry also feels that some positive value may come from SSARS after the banking community is educated

⁹⁷James R. Waterston, "Challenges Facing the Accounting Profession," The Journal of Accountancy 150 (September 1980) p. 86.

⁹⁸Thomas L. Stitchberry, "Compilation and Review: A Banker's Perspective," The Journal of Accountancy 149 (May 1980) p. 97.

⁹⁹Ibid., p. 98.

¹⁰⁰Jerry L. Arnold and Michael A. Diamond, The Market for Compilation, Review and Audit Services, p. XIV.

on all aspects of compilation and review and has had time to adjust to the changes.¹⁰¹

Bankers' Understanding of Compilation and Review Services

Do bankers really understand the difference between compilation and review services? Do they correctly interpret the message in the reports on compiled, reviewed and audited financial statements and calibrate the degree of reliance on the statements based on the reports? It is very important that the answers to these questions be yes if SSARS is to survive.

The Arnold and Diamond Study suggested that lending officers do understand the relative assurance provided by the various services offered by CPAs (compilation, review, audit). In addition bankers seemed somewhat familiar with the procedures associated with the different types of services. This research did question the extent to which bankers actually differentiate between the unaudited services (compilation, review) since some of those lenders surveyed tended to confuse compilation and review services with the unaudited disclaimer that existed before SSARS.¹⁰²

Edmonds, Porter and Weiss also investigated bankers' perceptions of the services offered by CPAs. The purpose

¹⁰¹Thomas L. Stitchberry, "Compilation and Review," p. 98.

¹⁰²Jerry L. Arnold and Michael A. Diamond, The Market for Compilation, Review, and Audit Services, p. 68.

of their study was to empirically determine if CPAs and bankers held similar perceptions of the procedures and levels of assurance conveyed in compilation, review and audit reports. The authors contended that in most cases bankers and CPAs do hold similar views on the procedures and the assurance conveyed by the different services offered by CPAs.¹⁰³ In those instances, in which the CPAs views differed from those of the bankers, the bankers tended to be more conservative. For example, the findings of their study indicated a substantial difference in opinion between CPAs and bankers on the conformity with generally accepted accounting principles in reviewed statements--CPAs tended to agree that reviewed statements are presented in conformity with GAAP but the bankers did not agree to the extent that the CPAs agreed. The authors interpreted this finding as a positive factor for the banking community since it indicates that bankers are not likely to place undue reliance on reviewed financial statements.¹⁰⁴

¹⁰³Thomas P. Edmonds, et al., "Do Bankers and CPAs Have Different Views of Reports on Financial Statements?" The Journal of Commercial Bank Lending 63 (June 1981) p. 52.

¹⁰⁴*Ibid.*, p. 60.

Summary of Chapter

This Chapter has discussed the evolution of SSARS, CPAs' perceptions of SSARS and bankers' perceptions of SSARS.

The accounting profession's struggle to clarify the CPA's responsibility in connection with unaudited financial statements has existed for many years. SSARS represents the profession's most recent attempt to put the "unaudited problems" to rest.

Members of the accounting and banking communities have expressed mixed feelings on the issuance of SSARS by the ARSC. Many accountants have expressed concern over the expression of limited assurance in the review engagement. Some bankers contend that they still have no way of determining exactly how much reliance can be placed on compilation and review services due to the latitude given to the accountant when performing the services.

Many accountants claim that SSARS clarifies practitioners' responsibility in unaudited engagements and puts the CPA in a better position to defend himself against liability claims concerning unaudited statements. Some bankers contend that the compilation and review classification is superior to the "unaudited" classification since bankers can now ascertain that the "unaudited" statements contain no assurance (the compilation) or limited assurance (the review).

CHAPTER III

METHODOLOGY

This chapter presents the methodology used in this investigation. The overall research plan is discussed for the CPAs and bankers. Details are given on the statement of the problem, questionnaire construction, data gathering procedures and statistical analysis.

Statement of the Problem

Preparers' and users' perceptions of compilation and review services have not been extensively investigated since the issuance of SSARS No. 1. Although many people have speculated on preparers' and users' perceptions of compilation and review services, such speculations have usually been without empirical support. As such, the problem that this research addressed was two-fold.

First, it appeared that there was substantial confusion in the financial community concerning the purpose and scope of compilation and review services. This problem manifested itself in that there continued to be a proliferation of articles in the accounting literature regarding practitioners' attitudes on SSARS and the various problems with SSARS.

Second, the literature lacked a sufficient number of empirical studies on bankers' perceptions of SSARS and, more importantly, bankers' perceptions of the procedures commonly associated with unaudited financial statements since the effective date of SSARS No. 1. Since bankers are the major third party users of unaudited statements, their perceptions are important. A knowledge of bankers' perceptions of SSARS and the procedures commonly associated with compiled and reviewed financial statements was desired since such knowledge could suggest a need to clarify SSARS or to educate the banking community on SSARS.

In an attempt to determine how bankers and CPAs felt about SSARS and the extent of confusion, if any, that existed concerning SSARS, this research surveyed Mississippi CPAs and bankers.

Objective of the Study

The basic objective of this study was to gain a better understanding of CPAs' and bankers' perceptions of SSARS and to determine if CPAs' and bankers' perceptions of the procedures commonly associated with compilation and review services were similar. Specifically, the objective of this study was to answer the following questions regarding Mississippi CPAs' and bankers' perceptions on compilation and review services:

CPAs

1. What is the overall attitude of Mississippi CPAs toward SSARS?
2. What type of procedures are Mississippi CPAs using in the compilation engagement? Are Procedures not contemplated by SSARS being used?
3. What type of procedures are Mississippi CPAs using in the review engagement? Are procedures not contemplated by SSARS being used?

Bankers

1. What is the overall attitude of Mississippi bankers toward SSARS?
2. What is the overall perception of Mississippi bankers of compiled statements?
3. What is the overall perception of Mississippi bankers of reviewed statements?

By answering these questions and comparing the answers, this research resulted in a better understanding of Mississippi CPAs' and bankers' perceptions of compilation and review services. The results should prove useful to Mississippi banking groups and CPA groups in evaluating the need for continuing professional education on unaudited financial statements.

Questionnaire Construction

Two questionnaires were used for this study; one for the CPAs and one for the bankers. A search of the literature led to the discovery of many instruments that had been used in pre-SSARS days to evaluate CPAs' and bankers' perceptions of unaudited financial statements. These instruments were found to be unsuitable for this study due

to the revolutionary changes brought about by SSARS No. 1. Although the literature search did lead to the discovery of several instruments that had been used in the SSARS era, none were considered broad enough to meet the present research objectives. Therefore, two instruments were developed to meet the current research objectives. CPAs and bankers assisted in the development of the instruments. Those instruments used in the pre-SSARS era also played an important part in the development of the instruments for this study.

CPAs' Instrument

The CPAs' questionnaire was designed to collect data on practitioners' overall perceptions of SSARS, the procedures commonly associated with compilation services and the procedures commonly associated with review services. To gather this information, the CPAs' instrument was developed with four sections.

Section I of the CPA instrument solicited practitioners' overall attitudes on SSARS. Twelve closed-end statements were made regarding SSARS (these included questions on the standards in general, the compilation, review, and legal liability). The participants were asked to respond to each statement by circling one of five available responses. A one to five point Likert-type scale ranging from "Strongly Agree" to "Strongly Disagree" was used for responses. The Likert system was chosen

because Likert-type questions allow collection of large amounts of information in a short time period. This increased the probability that the questionnaire would be returned.

Section II of the CPAs' questionnaire was designed to find out what type of procedures practitioners were using in compilation and review services; Section II-A dealt with the compilation engagement; Section II-B dealt with the review engagement.

In Section II the participants were given a series of: (a) administrative procedures, (b) inquiry procedures (c) analytical procedures and (d) audit procedures. The participants were asked to indicate the frequency with which they routinely used each of the procedures during 1983 when engaged to: (a) compile financial statements and (b) review financial statements (if the participant was unaware of his firms' policy or was not involved in a compilation and/or review engagement during 1983 he was asked to indicate the frequency with which he thought that he would have used the procedure had he been involved in the engagement). A one to five point Likert-type scale of "Always" to "Never" was used for responses.

The procedures listed in Section II were limited to three administrative procedures, five inquiry procedures, four analytical procedures and four audit procedures. The list was restricted to sixteen procedures so that the questionnaire would not be too long. Although SSARS gives

the CPA a great deal of latitude in the selection of the procedures to be used in the compilation and review, SSARS No. 1 contains a list of suggested procedures to be used in accounting and review services. Only those administrative, inquiry or analytical procedures suggested by SSARS or practitioners were included in the questionnaire. Those administrative procedures selected consisted of items appropriate for the compilation engagement and the review engagement; the inquiry and analytical procedures consisted of procedures possibly applicable to the compilation engagement but definitely applicable to the review engagement; the audit-type procedures consisted of items not routinely associated with the compilation or the review engagement.

The participants were asked to indicate their frequency of use of each procedure for the compilation and for the review (although the procedure may not have been appropriate for the engagement) due to claims by some practitioners that the distinction between the compilation, review, and the audit are unclear, the result being the use of audit-type procedures in the review and/or compilation and the extensive use of analytical procedures and inquiry procedures in the compilation. Also, the CPA is under a duty to exercise due professional care when engaged to compile or review financial statements; some have claimed that this had led to the use of audit-type procedures in accounting and review services engagements.

Section III consisted of selected demographic information. Also, the practitioners were asked to indicate their familiarity with SSARS in this section. A one to five point Likert-type scale of "Not at All" to "Very Familiar" was used to report this information. Section IV of the questionnaire was reserved for any comments that the participants wished to make.

Pretest of the CPAs' Questionnaire. A pretest of the CPA questionnaire was conducted using CPAs in the Starkville and Jackson areas. The pretest resulted in some minor adjustments in the wording of several questions to improve the clarity of the questionnaire.

Bankers' Instrument

The bankers' instrument was designed to collect data similar to that collected on the CPAs' instrument, i.e. bankers' attitudes towards SSARS, bankers' perceptions of the CPAs' responsibility to employ selected procedures in a compilation, and bankers' perceptions of the CPAs' responsibility to employ selected procedures in a review. To collect this information, the bankers' instrument was divided into four sections.

Section I of the bankers' instrument was designed to solicit bankers' overall attitude toward SSARS. A total of twelve closed-end statements were made concerning bankers' use of unaudited financial statements in the credit granting process, the degree of reliance placed on

such statements and the perceived benefits of the changes in unaudited financial statements brought about by SSARS. A one to five point Likert-type scale ranging from "Strongly Agree" to "Strongly Disagree" was used for the responses to the statements.

In Section II the bankers were told to assume that experienced CPAs had been engaged to compile financial statements when answering II-A and review financial statements when answering II-B. The bankers were also told to assume that appropriate accounting standards would govern the engagements. The bankers were then given some of the same inquiry, analytical and audit-type procedures given to the CPAs. The bankers were asked to indicate their perceptions of the CPAs responsibility to routinely perform the given procedures when engaged to (a) compile financial statements and (b) review financial statements. A one to five point Likert-type scale of "Always" (the CPA has a responsibility to always perform this procedure in the engagement) to "Never" (the CPA never has a responsibility to perform this procedure in the engagement) was given for the bankers' responses.

Selected demographic information was solicited in Section III of the bankers' questionnaire. The participants were also asked to indicate the extent of their familiarity with SSARS in this section using a one to five point Likert-type scale of "Not At All Familiar" to "Very Familiar". In the event that a banker indicated a very

low familiarity with SSARS he was asked to indicate his perception of how important it is that the banking community be able to ascertain the responsibility taken by the CPA when financial statements (prepared by a CPA) are submitted along with a loan application. A one to five point Likert-type scale of "Not At All Important" to "Very Important" was used to collect this information. Section IV of the bankers' instrument was reserved for any comments that the bankers desired to make.

Pretest of the Bankers' Questionnaire. A pretest of the bankers' questionnaire was conducted using bankers in the Starkville and Tupelo areas. This pretest resulted in some minor adjustments in the wording of several of the questions to improve the clarity of the instrument.

Evaluation of the Questionnaires

According to C. William Emory a good questionnaire must have the characteristics of validity, reliability, and practicality.¹ Validity refers to the extent to which the questionnaire measures what the researcher wishes to measure; reliability refers to the consistency of the measurement and practicality is concerned with a number of

¹C. William Emory, Business Research Methods, Homewood, Illinois: Richard D. Irwin, Inc. 1980. p. 128.

factors including economics, convenience and interpretability.² Although various statistical procedures have been developed to quantify validity and reliability, the instruments used in this study were not tested for validity and reliability using such procedures; a subjective evaluation was employed. Bankers and CPAs assisted in the design of the research instruments to ensure a high degree of validity and reliability. The resulting instruments are similar to those used to test bankers' and CPAs' perceptions of unaudited financial statements in the pre-SSARS era. The users of this type of instrument have expressed satisfaction with this type of instrument and have not reported any problems with its validity or reliability.³ The instrument proved very practical for this research effort.

Data Gathering Procedures

This research required that a sample of Mississippi CPAs and bankers be selected. These CPAs and bankers were mailed questionnaires and a limited number were interviewed before and after the questionnaires were mailed.

²Ibid.

³For examples of questionnaires used in the pre-SSARS era see: D. Raymond Bainbridge, "Unaudited Statements--Bankers' and CPAs' Perceptions," The CPA Journal 22 (December 1979) pp. 11-17. Also see Alan J. Winters, "Bankers Perceptions of Unaudited Financial Statements," The CPA Journal 14 (August 1975) pp. 29-33.

An overview of the sample selection process and the results follows.

Selection of CPAs

A major task of any survey research is the identification of the population to be sampled. The population for this study was narrowly defined as all Mississippi resident CPAs engaged in public accounting practice. Nonresidents were excluded from the population due to the desired emphasis on Mississippi; CPAs not engaged in public practice were excluded due to the practical nature of accounting and review services.

A 1983 Directory of Mississippi CPA Certificate Holders was obtained from the Mississippi State Board of Public Accountancy in an attempt to identify those individuals that resided within the state and engaged in public accounting practice. The directory lacked the information needed to separate the targeted population from all the other CPAs in the state. A call to the Mississippi State Society of CPAs resulted in the procurement of the state society's yearbook. The yearbook contained the information needed to identify most of the Mississippi resident CPAs engaged in public practice. Although it was not necessary that a Mississippi resident CPA be a member of the State Society of CPAs, the state society estimated that only 100 to 150 Mississippi resident CPAs were not members of the state society;

information was not available on the percentage of the nonmembers engaged in public practice. Since the state society of CPAs yearbook represented the best source available to select the sample, it was used. The yearbook contained approximately 800 Mississippi resident CPAs engaged in public practice.

Sample Size. After identification of the names and addresses of the population for the study, the next step was to select an appropriate sample size. Although statistical formulas have been developed to determine the appropriate sample size, the researcher decided to bypass this option due to the descriptive nature of the study and broad scope of the survey instrument. Descriptive studies have been cited as using large samples.⁴ Some authors suggest that descriptive studies should include ten to twenty percent of the accessible population.⁵ This research started with thirty percent of the population in an attempt to get enough returns to satisfy this ten to twenty percent criterion. Two-hundred-forty (30% of targeted population of 800) Mississippi resident CPAs engaged in public accounting practice were selected from the alphabetized section of The Mississippi Certified

⁴Donald Ary, et al., Introduction to Research In Education (New York: Holt, Rinehart and Winston, Inc., 1979) p. 135.

⁵Ibid.

Public Accountant 1983-1984 (the state society of CPAs yearbook). Systematic selection was employed. Each CPA selected was mailed one questionnaire and asked to return the questionnaire as soon as possible in a postage paid return envelope enclosed with the questionnaire. Although the participants were guaranteed confidentiality, all surveys were coded in a manner that permitted the researcher to identify those individuals that failed to return the questionnaires.

CPAs' response. The initial response to the CPAs' questionnaire was approximately twenty percent or 47 questionnaires. Although a response rate of twenty percent is not uncommon for mailed questionnaires, it was decided to send out a second request to those individuals who did not respond to the first request. This second request was sent out approximately two weeks after the first request. An additional questionnaire and a postage paid return envelope were also enclosed in the second request. Forty-eight additional questionnaires were returned. A total of 95 usable questionnaires was received. Since a few of the CPAs did not answer all of the questions, the results are presented in terms of usable responses which ranged from 90 to 95 in most instances. An additional 11 unusable questionnaires were returned. These carried notations that the CPA was no longer in practice, practiced as a lawyer, etc. Details

of the overall CPA mail out and responses are presented in Figure 3.1.

Figure 3.1

CPAs' QUESTIONNAIRE DISTRIBUTION AND RESPONSES

Total Number of Questionnaires Distributed.240
Total Number of Usable Questionnaires Received.	95
Unadjusted Response Rate.40%
Total Number of Unusable Questionnaires Returned.	11
Adjusted Response Rate.41%
Percentage of Population Represented.12%

Evaluation of Nonresponses. Any survey bears an element of risk due to the opinions of the nonrespondents. In this study, a random sample of nonrespondents were telephoned at their place of employment. Although most of the calls were unsuccessful, those nonrespondents contacted indicated that they did receive the survey but did not return it due to the time constraints of the tax season. Several additional questionnaires were received as a result of the phone calls. Efforts to secure additional responses were halted after the additional responses were received since the overall response rate exceeded the minimum response rate established earlier (i.e., ten percent of the accessible population) and the

latter returns failed to show any apparent differences in responses from those received earlier.

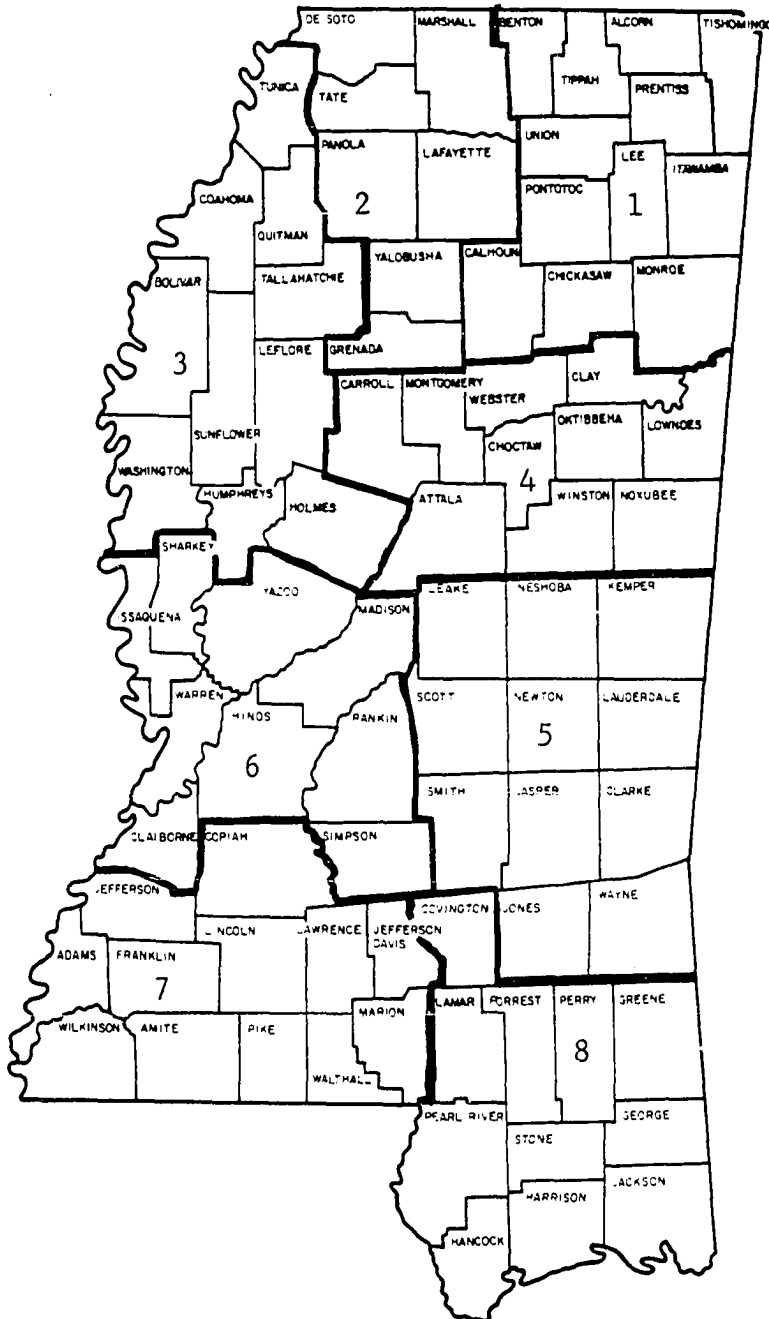
Selection of Bankers

A group of bank loan officers located throughout the state of Mississippi was surveyed for the second half of this research. In checking with the Mississippi Bankers' Association it was discovered that a detailed list of the names and addresses of all the bank loan officers in the state was not available. Since the state had over 160 parent banks, it was considered impractical to write each bank and request a list of the loan officers. Also, it was doubtful that the banks would supply such a listing. Due to these constraints, the bankers selected to participate in this research were not selected at random. Plans were made to solicit banks in the state that wished to participate in the study and have the banks distribute the questionnaires to their loan officers.

The Mississippi bankers are divided into eight geographical groups; these groups are shown in Figure 3.2. In order to ensure representation throughout the state, two banks in each of the geographical groups were selected; the presidents of each of the banks selected were contacted by letter. They were given an overview of the research project and asked if they would like for their bank to participate in the study. Twelve of the initial sixteen bank presidents responded stating that their

Figure 3.2

GEOGRAPHICAL GROUPS OF THE MISSISSIPPI BANKERS ASSOCIATION



institution would participate in the study. Four alternative banks were contacted by phone to take the place of the four banks that failed to respond or indicated that they did not wish to participate in the study. Substitutes were easily found.

The sixteen bank presidents (or an individual appointed by the president) were mailed a number of banker questionnaires. Most had indicated the number of questionnaires that they could use in the reply to the request to participate. The presidents were instructed to distribute the questionnaires to loan officers throughout their banking system. A postage paid return envelope was attached to each questionnaire so that all questionnaires could be returned directly to the researcher.

A total of 162 questionnaires were distributed to the sixteen banks selected to participate in the study. This represents approximately 10% of the parent banks in the state.

Bankers' response. A total of 101 bankers' questionnaires were returned. This represented a response rate of 62%. Details of the banker's questionnaire distribution and responses are given in Figure 3.3.

Since a few of the 101 respondents did not answer all of the questions, the number of usable responses was used in the statistical analysis. Because many of the parent banks that participated in the study had branches located

in a region other than the one in which the parent bank was located and the parent banks were instructed to distribute the questionnaires to loan officers located throughout their system (which may have included several regions) disaggregated information was not computed for the individual regions.

Figure 3.3

BANKERS' QUESTIONNAIRE DISTRIBUTION AND RESPONSES

Region	No. of Banks	Number of Questionnaires Distributed	Number of Responses	Response Rate
1	2	30	19	63%
2	2	10	3	30%
3	2	12	7	58%
4	2	23	14	61%
5	2	12	8	67%
6	2	30	23	77%
7	2	20	13	65%
8	2	25	14	56%
TOTALS	16	162	101	62%

Evaluation of Nonresponses. Since the bankers' survey instruments were distributed to the bank presidents and the bank presidents distributed the questionnaires to the loan officers, the bankers' survey was not amenable to

follow-up procedures. Due to the high response rate for the bankers, the researcher believes that nonresponse is not a significant factor in the study.

Statistical Analysis

Various measures of central tendency and dispersion were examined for each research question to achieve the research objective. The absolute and relative frequencies of the responses were also examined. In addition, various parametric and nonparametric statistics were considered in deciding which were more appropriate for this study. Specifically, analysis was needed in the following areas:

1. The determination of the difference, if any, between the CPAs' frequency of use of the selected procedures in the compilation as compared to the review.
2. The determination of the difference, if any, between bankers' perceptions of the responsibility of the CPAs to employ the different types of procedures (inquiry, analytical, audit) in a compilation engagement as compared to a review engagement.
3. The comparison of the frequency of use of the inquiry, analytical and audit type procedures by the CPAs with the bankers' perceptions of the CPAs' responsibility to use the procedures.
4. Various comparisons among the CPAs and bankers based on selected demographic variables.

Initial efforts to use the chi-square test of independence failed due to the restrictions that chi-square should not be used if more than 20% of the expected

frequencies are less than five.⁶ Although the problem could have been solved by combining some of the cells in the chi-square test, the researcher decided to by-pass this option since this would have limited the findings of the study. It was decided to try to use some parametric test which, in general, would be more powerful than the chi-square test and could be justified from a statistical standpoint.

The best alternative in this case to chi-square was the t-test in the evaluation of results between groups and one-way analysis of variance (ANOVA) in the evaluation of results among groups. The use of these techniques required that the data scale used in both the CPAs' instrument and the bankers' instrument be treated as interval. Although this treatment has been challenged by some statisticians, others have sanctioned such treatment, especially when the research is descriptive or exploratory in nature.⁷

All comparisons between the CPAs and bankers used the t-test with separate rather than pooled variances due to the presence of discrepancies in the variances between the groups. Although such a choice was not available in the

⁶See Robert D. Mason, Statistical Techniques In Business and Economics (Homewood, Illinois: Richard D. Irwin, Inc. 1978) p. 347.

⁷See Normal H. Nie, et al. Statistical Package for the Social Sciences (New York: McGraw-Hill, 1975) p. 6.

ANOVA procedures, the homogeneity of variance assumption used in ANOVA did not represent a significant problem in most instances since the ANOVA was not used in cross-group comparisons but was used only in comparisons among CPAs and among bankers.

All of the data collected was analyzed using selected programs found in the Statistical Package for the Social Sciences and SPSS Update 7 - 9.⁸

Summary of Chapter

This chapter has presented basic details on methodology used in this study. The statement of the problem, questionnaire construction, data gathering procedures and statistical analysis were discussed.

Preparers' and users' perceptions of compilation and review services have not been extensively investigated since the issuance of SSARS No. 1. Therefore, the basic objective of this study was to gain a better understanding of CPAs' and bankers' perceptions of SSARS and to determine if CPAs' and bankers' perceptions of the procedures commonly associated with compilation and review services were similar.

Two questionnaires were constructed for this study; one for CPAs and one for bankers. The questionnaires were

⁸C. Hadlai Hull and Norman H. Nie, SPSS Update 7 - 9 (New York: McGraw-Hill, 1981); Norman H. Nie, et al., Statistical Package for the Social Sciences, 2nd ed. (New York: McGraw-Hill, 1975).

designed to solicit: (1) CPAs' and bankers' attitudes toward SSARS, (2) the frequency with which CPAs used selected procedures in compilation services during 1983 and bankers' perceptions of the CPAs' responsibility to use the selected procedures, (3) the frequency with which CPAs used selected procedures in review services during 1983 and bankers' perceptions of the CPAs' responsibility to use the selected procedures. The questionnaires included selected inquiry, analytical and audit-type procedures. The CPAs' questionnaire also included selected administrative procedures.

Two-hundred-forty Mississippi resident CPAs engaged in public practice and 162 Mississippi bank loan officers were mailed questionnaires. The response rates were 41% and 62% respectively.

The responses were analyzed using selected programs found in the Statistical Package for the Social Sciences and SPSS Update 7 - 9. Various measures of central tendency were examined for each question to achieve the research objective. In addition, the absolute and relative frequencies of the responses were examined to aid in this task. The t-test was used in the evaluation of the results between the CPAs and bankers and, between the compilation and review. One-way analysis of variance (ANOVA) was used in the evaluation of the results among

the various subgroups (based on selected demographic variables).

The next chapter presents the findings and implications of the study.

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CHAPTER IV

RESEARCH FINDINGS AND IMPLICATIONS

This chapter presents the research findings. Implications of the findings are discussed throughout the chapter.

The first section of the chapter is devoted to the CPAs. Subsections include an overview of the CPA respondents, overall attitudes towards SSARS, procedures routinely used in a compilation, procedures routinely used in a review and a comparison of the compilation results with the review results.

The second section is devoted to the bankers. Subsections include an overview of the banker respondents, bankers' overall attitudes towards SSARS, bankers' perceptions of the CPAs' responsibility to use selected procedures in a compilation, bankers' perceptions of the CPAs' responsibility to use selected procedures in a review, and a comparison of bankers' perceptions of the compilation with the review.

The final section of the chapter is devoted to a comparison of the CPAs' use of selected procedures in unaudited engagements with bankers' perceptions of the

CPAs' responsibility to use the procedures. A summary of the chapter is also included.

Chapter Five summarizes the major findings and implications and makes recommendations and conclusions.

CPAs' Results

The following section is devoted to the research findings and implications concerning CPAs.

Overview of the CPA Respondents

Ninety-five Mississippi resident CPAs engaged in public accounting practice took part in this research effort. The respondents completed mailed questionnaires during the last two weeks in February and the first three weeks in March, 1984. The CPAs' questionnaire can be found in Appendix A. The unadjusted response rate for the CPAs was 40%.

Figure 4.1 presents an overview of the CPA respondents. As can be seen from the figure, the majority of the CPAs were associated with local or regional CPA firms. Approximately ninety-seven percent indicated that they had been involved with an engagement to compile and/or review financial statements of a nonpublic entity during 1983. Figure 4.1 also indicates that the respondents were more experienced with the compilation engagement than the review engagement: Fifty percent reported that their firm allocated from 10% to 25% of its chargeable time to the compilation services during 1983; about 67% reported less

FIGURE 4.1

OVERVIEW OF THE CPA RESPONDENTS

Firm Affiliation	Percent of Respondents	Compilation/Review Experience in 1983	Percent of Respondents
Sole Practitioner	16.1	Yes	96.8
Local or Regional	76.3	No	3.2
National or International	7.6		
TOTAL	100.0		100.0

Percent of 1983 Chargeable Time Associated with Compilation Services	Percent of Respondents	Percent of 1983 Chargeable Time Associated with Review Services	Percent of Respondents
Less than 10%	27.2	Less than 10%	66.7
10% to 25%	50.0	10% to 25%	26.7
26% to 40%	18.5	26% to 40%	5.6
41% to 55%	1.1	41% to 55%	1.0
Over 55%	3.2	Over 55%	0.0
TOTAL	100.0		100.0

Population of City in Which CPAs Employed	Percent of Respondents	Highest Educational Level of Respondents	Percent of Respondents
Less than 1,000	.0	High School	.0
1,000 to 10,000	10.8	Junior College	2.2
10,001 to 49,999	45.2	Four Years of College	64.5
50,000 to 100,000	7.5	Over Four Years	33.3
Over 100,000	36.5		
TOTAL	100.0		100.0

Age of Respondents at Last Birthday	Percent of Respondents	Self-reported Familiarity with SSARS	Percent of Respondents
Under 25	6.5	(1) Not at all	2.2
26 to 35	43.0	(2) *	4.3
36 to 45	26.9	(3) Somewhat Familiar	21.5
46 to 55	10.8	(4) *	39.8
Over 55	12.8	(5) Very Familiar	32.2
TOTAL	100.0		100.0

*Information reported on a 1 to 5 point Likert-type scale.
Source: Original Data, 1984

than 10% of 1983 chargeable time allocated to the review engagement. About 45% of the practitioners were employed in cities with populations of 10,000 to 50,000; about 36% were employed in cities with populations over 100,000. None were from cities with populations less than 1,000.

The formal educational level of the CPAs was high; 64.5% had completed four years of college and 33.3% reported completion of more than four years of college. The individuals surveyed were relatively young; almost 50 percent were less than 36 years old and 26.9% were between 36 and 45 years of age.

The CPAs were fairly familiar with SSARS: when asked to indicate their familiarity with SSARS, using a one to five point Likert-type scale, 93.6% indicated that they were "Somewhat Familiar" to "Very Familiar" with SSARS.

In summary, the CPAs surveyed in the study consisted of highly-educated Mississippi CPAs engaged in public accounting practice. An overwhelming majority were familiar with SSARS and had compilation and/or review experience.

Overall Attitudes Towards SSARS

The CPAs were asked to indicate their overall attitudes towards SSARS using a Likert-type one to five point scale. Ten of the twelve statements used in Section I of the CPAs' questionnaire were designed to solicit the practitioners' overall attitudes towards SSARS. The

statements were divided into three categories: (1) reaction to SSARS, (2) perceptions of the legal consequences of SSARS, (3) miscellaneous. The statements used to solicit the practitioners' attitudes of SSARS, the Likert-type scale, the percentage of respondents who selected each answer and the mean responses are presented in Figure 4.2

Overall, a substantial majority of the practitioners (85.9%) agreed that SSARS represented a positive development in the practice of public accounting; only 3.3% of the CPAs disagreed. However, it is interesting to note that only 32.2% of the CPAs agreed that their clients had a better understanding of the services they were obtaining in compilation or review engagements compared to previous "unaudited engagements." This was discussed with some of the participants in the follow-up interview process. In general, it was concluded that the profession had adjusted to the changes brought about by SSARS but had failed to exert a concentrated effort to educate the public about SSARS. One of the respondents stated:

The biggest problem with SSARS is the failure of the profession to educate the public as to the various levels of assurance available and to explain the various reports.

It is apparent that the profession must increase the public awareness of the major changes brought about by SSARS.

FIGURE 4.2
CPAs' OVERALL ATTITUDES TOWARDS SSARS

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Reactions to SSARS</u>							
1	Overall, SSARS represents a positive development in the practice of Public Accounting.....	42.4	43.5	10.9	3.3	.0	1.75
2	My clients have a better understanding of the services they are obtaining in compilation or review engagements, compared to previous unaudited engagements.....	7.5	24.7	21.5	24.7	21.5	3.28
3	The <u>compilation</u> of financial statements is a professional accounting service and the establishment of standards to cover such a service is good for public accounting practice.....	61.3	26.9	4.3	4.3	3.2	1.61
4	The Accounting and Review Services Committee erred when they recognized <u>compilation</u> of financial statements as a professional accounting service and established standards to cover compilation engagements.....	7.5	8.6	4.3	24.7	54.8	4.1
<u>Legal Consequences</u>							
5	The issuance of SSARS has led to a decrease in legal exposure when the CFA is associated with unaudited financial statements of the nonpublic entity.....	11.8	30.1	29.0	20.4	8.6	2.84
6	The risk of legal exposure is greater with a review engagement than with an audit engagement.....	26.1	46.7	16.3	7.6	3.3	2.15
7	The risk of legal exposure is greater with a review engagement than with a compilation engagement.....	7.6	16.3	18.5	31.5	26.1	3.52
<u>Miscellaneous</u>							
8	There are too many specific standards and procedures included in SSARS on the <u>compilation</u> of financial statements.....	10.9	19.6	17.4	37.0	15.2	3.26
9	There are too many specific standards and procedures included in SSARS on the <u>review</u> of financial statements.....	12.0	15.2	23.9	31.5	17.4	3.27
10	Many of the nonpublic clients that my firm once audited have substituted compilations and/or reviews since the issuance of SSARS.....	5.4	15.1	20.4	19.4	39.8	3.73

*1=strongly agree; 2=mildly agree; 3=neutral; 4=mildly disagree;
5=strongly disagree

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984

Although the accounting literature contained claims by some practitioners that the compilation engagement is not professional in nature and the establishment of professional standards to cover the compilation was an error, the majority of those surveyed held the opposite view. Approximately eighty-eight percent of the CPAs surveyed agreed that the compilation is professional and the establishment of professional standards (SSARS) to cover the compilation was good for public accounting practice.

When SSARS No. 1 was introduced, it was held as a major step to limit the CPAs' liability exposure resulting from unaudited engagements. The topic of the legal consequences of SSARS was heavily debated before the issuance of SSARS No. 1 and continues to be debated today. Due to the absence of a significant number of court decisions, however, it is impossible to determine the exact legal consequences of SSARS. In spite of this ambiguity, the CPAs were queried concerning their perceptions of the legal consequences of SSARS. As indicated in Figure 4.2 a majority of the CPAs did not feel that SSARS has resulted in a decrease in CPAs legal exposure in unaudited engagements: 41.9% of the practitioners agreed that SSARS had led to a decrease in CPAs' legal exposure when the practitioners are associated with unaudited financial statements; 29% disagreed. A majority of the CPAs (72.8%) did agree that the risk of legal exposure is

greater with a review than with an audit. In general, it may be concluded that practitioners are split on their perceptions of the legal consequences of SSARS. A majority of the CPAs did not feel that SSARS had accomplished what it was supposed to accomplish, i.e., a decrease the CPAs' legal exposure in unaudited engagements. More time and additional case law will be needed to objectively evaluate the issue of the CPAs' legal exposure in compilation and review services. However, it is evident that the practitioners viewed the review as a high risk engagement since most felt that the legal exposure in a review is greater than the legal exposure in an audit. This is ironic since the audit involves greater assurance and responsibility on the part of CPAs.

The CPAs were also queried regarding the standards and procedures included in SSARS on the compilation and review of financial statements. The responses for statements 8 and 9 in Figure 4.2 indicate that more CPAs disagreed than agreed that SSARS contains too many standards and procedures on the compilation and review of financial statements. Many of the CPAs were neutral. The guidance provided by SSARS was discussed with some of the CPAs in follow-up interviews. Also, some practitioners made comments concerning the guidance provided by SSARS. The interviews and comments suggested that most CPAs who routinely prepared compilations and reviews were satisfied with SSARS guidance on the compilation but not the review.

In general, many CPAs felt that the inquiry and analytical procedures, called for by SSARS in a review, were usually not adequate to express the limited assurance contemplated by a review. Although SSARS states that additional procedures may be used, the pronouncements fail to specify the nature of the additional procedures. This bothered some practitioners since they wanted to use audit-type procedures that are not routinely contemplated in a review. Furthermore, some of the CPAs felt that the use of audit-type procedures in a review could result in additional legal exposure in the event of litigation.

Before SSARS No. 1 was issued some CPAs speculated that the standards would lead to a downgrading of accounting services from the audit to the review or compilation. Figure 4.2 statement 10 indicates that some downgrading of services has occurred as a result of SSARS: 20.5% of the CPAs agreed that many of the nonpublic clients that they once audited have substituted compilations and/or reviews in the place of audits since the issuance of SSARS. However, some of the practitioners felt that this downgrading of services was not necessarily negative. In some instances the nonpublic clients that used to get audited financial statements can now satisfy bankers or silent partners with a compilation or review instead of an audit. This saves the client money. In general the CPAs did not encourage any downgrading of services since the audit is a more complete service and in many instances results in a

net savings to the client. The practitioners indicated that the client may realize saving through the audit as a result of increased efficiencies brought about by the study and evaluation of internal control (not commonly done in a compilation or review) and, in some instances, by the detection of errors or irregularities that are more likely to be detected in an audit as opposed to a compilation or review.

In summary, most of the practitioners surveyed thought SSARS represented a positive development in public accounting practice but felt that the clients for whom they performed compilation or review services did not understand the services any better than the pre-SSARS unaudited engagements. The practitioners were split on the legal consequences of SSARS: less than a majority either agreed or disagreed that SSARS has led to a decrease in the CPAs' legal exposure in unaudited engagements; many of the practitioners (29%) were neutral on the subject. A majority of the CPAs' felt that the risk of legal exposure is greater in a review than in an audit. Many of the practitioners called for additional guidance in the review engagement and a small percentage indicated that SSARS had resulted in the substitution of reviews and compilations for audits.

Procedures Used in the Compilation

SSARS No. 1 paragraphs 9 - 13 states that the CPA must have an overall knowledge of an entity's operations and the accounting principles and practices of the industry in which the entity operates before compiling the entity's financial statements. In addition, the CPA must read the financial statements to ensure that they are free from "obvious material errors."

The charge that the CPA must read the compiled financial statements and make sure that they are free from "obvious material errors" has caused some concern among practitioners because SSARS No. 1 paragraph 13 broadly defines "obvious material errors" to include clerical mistakes and mistakes in the application of accounting principles (including inadequate disclosures). Some have claimed that this mandate has led to the use of procedures not contemplated by SSARS in the compilation of financial statements.

The practitioners were asked to indicate the frequency with which they routinely used selected procedures during 1983 in the compilation engagement in Section II A of the CPAs' questionnaire. A one to five point Likert-type scale ranging from "Always" to "Never" was used to solicit the information. The procedures used in Section II included selected administrative procedures, inquiry procedures, analytical procedures and audit-type procedures. The procedures, the CPAs' responses to the

procedures, and the Likert-type scale are presented in Figure 4.3. The mean responses are also presented.

Administrative. Although SSARS No. 1 paragraph 8 charges the CPA to establish an understanding with the client, preferably in writing, regarding the services to be rendered, the results of this research revealed that the use of an engagement letter was not very common among practitioners: 41% indicated that they rarely or never used an engagement letter in a compilation engagement; 15.8% indicated that they used an engagement letter only occasionally. This matter was discussed with some of the participants. In general it was concluded that the use of an engagement letter was not common among many practitioners before SSARS; many practitioners felt the sudden use of an engagement letter would create friction between the CPA and client and would void a mutual trust which had existed, in some cases, for many years. In addition, some practitioners stated that their clients, in many instances, felt threatened when presented with an engagement letter and a request to sign it and return a copy. For this reason most of those practitioners that had started using an engagement letter with existing clients since the issuance of SSARS No. 1 stated that they used a "letter of agreement". In this case the client is forwarded a letter stating the terms of the engagement but is not asked to sign it and return a copy. The client's only duty is to

FIGURE 4.3

CPAs' USE OF SELECTED PROCEDURES IN A
COMPILATION ENGAGEMENT DURING 1983

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Administrative</u>							
1	Used an engagement letter.....	30.5	12.6	15.8	24.2	16.8	2.84
2	Obtained management representations.....	17.9	6.3	15.8	30.5	29.5	3.47
3	Used some sort of procedures "checklist".....	42.1	25.3	12.6	15.8	4.2	2.14
<u>Inquiry</u>							
4	Inquired concerning action taken at meetings of board of directors.....	14.7	17.9	23.2	24.2	20.0	3.16
5	Inquired concerning the entity's accounting principles and practices and the methods followed in applying them.....	57.9	17.9	17.9	2.1	4.2	1.76
6	Ascertained that the financial statements were mathematically correct....	96.8	.0	3.2	.0	.0	1.06
7	Ascertained that the financial statements and the general ledger were in agreement.....	91.6	5.3	1.1	.0	2.1	1.15
8	Reviewed the statements with the client before rendering the report.....	34.7	27.4	23.2	13.7	1.1	2.18
<u>Analytical</u>							
9	Compared the current statements with anticipated results (budgets or forecasts) when available.....	19.1	16.0	27.7	24.5	12.8	2.96
10	Compared the current statements with prior year statements when available.....	52.6	30.5	10.5	2.1	4.2	1.74
11	Computed ratios and investigated significant fluctuations.....	11.6	26.1	23.2	22.1	16.8	3.06
12	Compared the entity's ratios with industry ratios, when available.....	1.1	8.4	24.2	30.5	35.8	3.91
<u>Audit</u>							
13	Confirmed the cash balance directly with the bank....	4.2	7.4	22.1	27.4	38.9	3.89
14	Observed the counting of the physical inventory....	2.1	4.2	6.3	18.9	68.4	4.47
15	Evaluated the more important accounting controls..	6.3	12.6	29.5	23.2	28.4	3.54
16	Confirmed the accounts receivable balance directly with debtors.....	2.1	2.1	7.4	18.1	70.2	4.52

*1=always; 2=frequently; 3=occasionally; 4=rarely; 5=never.

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984.

notify the CPA firm should he disagree with something in the letter.

Letters of representation are commonly used in the audit engagement. Such letters are usually prepared by officers of the client company at the auditors' request and set forth certain facts about the company's financial position or operations. Although SSARS does not charge the CPA to obtain representations in the compilation engagement, Figure 4.3 indicates that 24.2% of the respondents always or frequently obtained representations in the compilation engagement. Some practitioners stated that this is the best way to impress upon the client that he has ultimate responsibility for the compiled financial statements.

Procedures checklists are guidelines covering the steps to be followed in compilation and review services. A large number of procedures checklists have been published since the issuance of SSARS No. 1. Sixty-seven percent of the respondents indicated that they always or frequently used a procedures checklist in the compilation engagement. Since the compilation engagement is covered by Rule 201 of the AICPA Code of Professional Ethics (The General Standards), many practitioners felt that the procedural checklist was a valuable aid in documenting compliance with Rule 201.

Disaggregated data by the type of CPA firm is given in Figure 4.4 for the three administrative items listed in

the questionnaire. The measure of statistical significance is based on the F-statistic used in standard one-way analysis of variance. At alpha = .05 the means are significantly different among the type of firms with which the CPAs were associated. In general, the analysis indicates that the national firms were more likely to use an engagement letter, obtain management representations, and use a procedural checklist in a compilation.

Figure 4.4

CPAs' USE OF SELECTED ADMINISTRATIVE PROCEDURES IN A
COMPILATION ENGAGEMENT BY TYPE OF FIRM

Procedure	No. of Re- sponses	Means for National Firms n = 7	Means for Local or Regional Firms n = 71	Means for Sole Prac- titioners n = 15	Sig- nifi- cance
Use an engagement letter	93	1.28	2.97	2.86	.017*
Obtained management representa- tions	93	1.57	3.71	3.26	.000*
Used a procedural checklist	93	1.00	2.16	2.46	.029*

NOTE: Means were computed using the Likert-type scale
(1 = always, 5 = never).

*Difference are statistically significant.

SOURCE: Original data, 1984

Inquiry. Figure 4.3 indicates that all of the inquiry procedures listed in the CPAs' questionnaire except an inquiry concerning action taken at meetings of the board of directors were frequently used when the practitioners compiled financial statements during 1983. Some of the practitioners mentioned that an inquiry concerning actions taken at the board of directors is beyond the scope of compilation engagements; others noted that the majority of compilation engagements involve entities without a board of directors.

An attempt was made to determine why 14.7% of the CPAs rarely or never review the compiled statements with the client before issuing the report (Figure 4.3 - statement 8). The search revealed that the procedure of reviewing the compiled statements with the client before issuing the report was very common for new or relatively new clients; after the practitioner has served the client for a number years, such a procedure is usually unnecessary. The practitioner seeks most of the information needed from the client in the pre-compilation conference and that is sufficient to compile the financial statements and issue the report.

Analytical. Figure 4.3 reports that most of the analytical procedures listed in the questionnaire were not used very frequently in compilation engagements. This is not surprising since SSARS does not mandate the use of

analytical procedures in a compilation. With regard to the analytical procedure of comparing the current statements with prior year statements when available (Figure 4.3 - statement 10), the follow-up interviews revealed that this is very common due to the tendency to present comparative financial statements. It is also interesting to note that those CPAs who elected to use analytical procedures in a compilation use them to help uncover "obvious material errors". Some practitioners felt that analytical procedures represented the most powerful tool available to identify items that were "out-of-line" and were a necessity in a full disclosure compilation.

Audit. Figure 4.3 indicates in general that the audit procedures listed in the questionnaire were rarely or never used by the CPAs. This was expected since audit procedures are definitely not expected in a compilation. However, 18.9% of the CPAs indicated that they always or frequently evaluated internal accounting controls in a compilation engagement; 11.6% indicated that they always or frequently confirmed the cash balance directly with the bank. Some practitioners noted that the cash (since it is a high risk item) was sometimes confirmed due to the ease with which it can be done. Others stated that they would question the use of any of the audit procedures routinely in a compilation due to the possibility of increased legal exposure.

Procedures Used in the Review

To review financial statements the CPA must have an overall knowledge of the entity's operations and the accounting principles and practices of the industry in which the entity operates. In addition, SSARS No. 1 paragraph 24 charges the CPA to use inquiry and analytical procedures to obtain limited assurance that there are no material modifications that should be made to the financial statements. SSARS gives the CPA a great amount of latitude in the selection of inquiry and analytical procedures for a review. The routine use of audit-type procedures is not contemplated by SSARS in the review of financial statements.

The practitioners were asked to indicate the frequency with which they routinely used the same administrative, inquiry, analytical, and audit-type procedures used in the compilation section when engaged to review financial statements during 1983. The same Likert-type one to five point scale used in the compilation section was also used in the review section. The procedures, the CPAs' responses to the procedures, and Likert-type scale are presented in Figure 4.5. The mean responses to the procedures are also given.

Administrative. Figure 4.5 indicates that all of the administrative procedures listed in the questionnaire were used frequently in the review engagement. However, it is

FIGURE 4.5

CPAs' USE OF SELECTED PROCEDURES IN A
REVIEW ENGAGEMENT DURING 1983

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Administrative</u>							
1	Used an engagement letter.....	59.3	8.8	11.0	12.1	8.8	2.02
2	Obtained management representations.....	51.6	22.0	7.7	11.0	7.7	2.01
3	Used some sort of procedures "checklist".....	65.6	14.4	8.9	5.6	5.6	1.71
<u>Inquiry</u>							
4	Inquired concerning action taken at meetings of board of directors.....	50.5	27.5	9.9	7.7	4.4	1.87
5	Inquired concerning the entity's accounting principles and practices and the methods followed in applying them.....	78.0	16.5	4.4	.0	1.1	1.29
6	Ascertained that the financial statements were mathematically correct....	97.8	1.1	1.1	.0	.0	1.03
7	Ascertained that the financial statements and the general ledger were in agreement.....	95.6	3.3	1.1	.0	.0	1.05
8	Reviewed the statements with the client before rendering the report.....	48.4	30.8	12.1	8.8	.0	1.81
<u>Analytical</u>							
9	Compared the current statements with anticipated results (budgets or forecasts) when available.....	28.6	25.3	19.8	17.6	8.8	2.53
10	Compared the current statements with prior year statements when available.....	69.2	22.0	7.7	1.1	.0	1.40
11	Computed ratios and investigated significant fluctuations.....	39.6	34.1	11.0	11.0	4.4	2.06
12	Compared the entity's ratios with industry ratios, when available.....	8.8	24.2	25.3	19.8	22.0	3.22
<u>Audit</u>							
13	Confirmed the cash balance directly with the bank....	29.7	20.9	11.0	13.2	25.3	2.83
14	Observed the counting of the physical inventory....	11.0	12.1	9.9	24.2	42.9	3.75
15	Evaluated the more important accounting controls..	25.0	27.2	17.4	14.1	16.3	2.69
16	Confirmed the accounts receivable balance directly with debtors.....	8.8	8.8	15.4	22.1	45.1	3.85

*1=always; 2=frequently; 3=occasionally; 4=rarely; 5=never.

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984.

interesting to note that 20.9% of the practitioners reported that they rarely or never use an engagement letter in a review, in spite of SSARS guidance that the CPA should establish an understanding with the client, preferably in writing, regarding the services to be performed. Again, this matter was discussed with some practitioners in the follow-up process. In general, it was concluded that some practitioners did not use engagement letters before SSARS and will not use engagement letters unless they are required.

SSARS No. 1 paragraph 31 states that the CPA may wish to obtain management representation in the review but the statement stops short of requiring management representations. A large majority of the respondents (73.6%) indicated that they always or frequently obtained management representation in the review engagement. Eighty percent of the practitioners indicated that they always or frequently used some sort of procedural checklist.

Inquiry. SSARS No. 1 states that the inquiries to be made in a review are a matter of the accountants' judgment. However, the statement makes it clear that inquiry is a must in the review engagement. Figure 4.5 indicates that the respondents made very extensive use of the inquiry procedures listed on the questionnaire. Discussions with some of the CPAs indicated that most had

developed inquiry type questionnaires to be filled out by the client in a review.

Analytical. The analytical procedures presented in the questionnaire lagged far behind the inquiry procedures in their frequency of use in the review engagement. Discussions with some of the practitioners revealed that some questioned the power of analytical procedures to help the CPA obtain limited assurance in the reviewed financial statements. One practitioner stated:

When a new business is involved or the client has experienced a major change in his business, analytical procedures are not very helpful.

The practitioner went on to say that SSARS lacks sufficient guidance on what should be done in such a case since audit-type procedures would appear to be necessary, yet, to use the audit procedures might result in increased legal exposure.

Other practitioners felt that analytical procedures are very helpful in acquiring limited assurance but also felt that the selection of the appropriate analytical procedures for the circumstances and the interpretation of the results requires specialized knowledge that may not exist in a small CPA's office. The relationship between the use of the analytical procedures in a review and the type of CPA firm was examined; the results appear in Figure 4.6. The measure of statistical significance used in the table is based on the F-statistic used in standard

Figure 4.6

CPAs' USE OF SELECTED ANALYTICAL PROCEDURES IN A
REVIEW ENGAGEMENT BY TYPE OF FIRM

Analytical Procedure	Number of Responses	Mean for National/ International Firms n = 6	Mean for Local or Regional Firms n = 69	Mean for Sole Practitioner n = 15	Significance
Compared the current statements with anticipated results (budgets of forecast) when available	90	2.00	2.52	2.80	.4533
Compared the current statements with prior year statements when available	90	1.16	1.34	1.80	.0000*
Computed ratios & investigated significant fluctuations	90	1.83	2.02	2.33	.5846
Compared the entity's ratios with industry ratios, when available	90	3.166	3.23	3.26	.9871

NOTES: Means were computed using the Likert-type scale (1=always, 5=never).

*Differences are statistically significant

SOURCE: Original data, 1984

one-way analysis of variance. At alpha = .05 the analysis failed to show any significant difference between the use

of analytical procedures and the type of CPA firm in three of the four analytical procedures. It is interesting to note that the comparison of the entity's ratios with the industry ratios analytical procedure received the lowest rating for frequency of use in a review engagement. In general, the discussions with the practitioner revealed that it is difficult to find industry information for many of those clients seeking a review (since the entity must be nonpublic).

Audit. Figure 4.5 indicates that some of the audit-type procedures were frequently used by the CPAs, despite SSARS lack of contemplation of audit-type procedures in a review. A majority of the practitioners (50.8%) indicated that they always or frequently confirmed the cash balance directly with the bank in a review and a majority (52.4%) also indicated that they always or frequently evaluated the more important internal accounting controls in a review. In addition, 22.2% of the practitioners indicated that they always or frequently observed the counting of the physical inventory and 17.6% indicated that they always or frequently confirmed the accounts receivable balance directly with the debtors. It is apparent that some practitioners are routinely using audit-type procedures more frequently than anticipated by SSARS. In the follow-up interview process, some practitioners stated that the use of some auditing procedures in a review is

not uncommon--especially when the entity is new or has undergone major changes and analytical procedures are not very helpful in achieving limited assurance. Furthermore, some of the practitioners felt that audit-type procedures are, in general, needed to express the level of assurance contemplated in the review.

Comparison of the Compilation with the Review.

A comparison of the frequency with which the CPAs used the procedures in a compilation as compared to a review is presented in Figure 4.7. The measure of statistical significance for Figure 4.7 is based on the t-statistic. At alpha = .05 the Figure 4.7 shows a statistical (see two-tail probability column) difference between the overall frequency of use of the selected procedures in the compilation engagement as compared with the review for all of the administrative, analytical and audit procedures presented. Also, three of the five inquiry procedures show a significant difference between their overall frequency of use in the compilation as compared with the review.

The only two procedures in Figure 4.7 for which the t-test failed to show a statistical significance between the compilation and review engagements were: (1) ascertained that the financial statements were mathematically correct (Number 6) and (2) ascertained that the financial statements and the general ledger were in agreement

FIGURE 4.7

COMPARISON OF THE CPAs' USE OF SELECTED PROCEDURES IN A
COMPILATION ENGAGEMENT WITH THE REVIEW ENGAGEMENT

Nos.	PROCEDURES	Compilation Means	Review Means	Two-tail Probability
<u>Administrative</u>				
1	Used an engagement letter.....	2.85	2.02	.000*
2	Obtained management representa- tions.....	3.49	2.01	.000*
3	Used some sort of procedures "checklist".....	2.16	1.71	.000*
<u>Inquiry</u>				
4	Inquired concerning action taken at meetings of board of directors.....	3.19	1.87	.000*
5	Inquired concerning the entity's accounting principles and prac- tices and the methods followed in applying them.....	1.78	1.29	.000*
6	Ascertained that the financial statements were mathematically correct.....	1.06	1.03	.181
7	Ascertained that the financial statements and the general led- ger were in agreement.....	1.15	1.05	.083
8	Reviewed the statements with the client before rendering the report.....	2.21	1.81	.000*
<u>Analytical</u>				
9	Compared the current statements with anticipated results (budgets or forecasts) when available.....	3.0	2.53	.000*
10	Compared the current statements with prior year statements when available.....	1.76	1.40	.000*
11	Computed ratios and investigated significant fluctuations.....	3.09	2.06	.000*
12	Compared the entity's ratios with industry ratios, when available.....	3.93	3.21	.000*
<u>Audit</u>				
13	Confirmed the cash balance directly with the bank.....	3.89	2.83	.000*
14	Observed the counting of the physical inventory.....	4.47	3.75	.000*
15	Evaluated the more important accounting controls.....	3.57	2.69	.000*
16	Confirmed the accounts receiv- able balance directly with debtors.....	4.52	3.85	.000*

Note: Means were computed using the Likert-type scale (1=always, 5=never).

*Differences are statistically significant

Source: Original data, 1984.

(Number 7). This is not surprising, for these two are procedures that any reputable CPA would perform in any engagement.

A review of Figure 4.7 shows that in all other instances the review mean is smaller than the compilation mean. This implies that the CPAs were more likely to perform the procedure in a review engagement than in a compilation engagement.

These results imply that SSARS has been successful in creating two classes of unaudited financial statements with different levels of assurance warranted by the different reports.

Summary

This section has presented the major CPAs research findings and implications.

The findings indicated that most CPAs viewed SSARS as a positive step to solve the profession's problem with unaudited statements. However, more practitioners disagreed than agreed that their clients had a better understanding of the services they were obtaining in compilation and review engagements compared to previous unaudited engagements. The results failed to indicate that the majority of CPAs perceive that SSARS has led to a decrease in the CPAs' legal exposure in unaudited engagements, and some of the practitioners questioned the CPAs' ability to express limited assurance in the review by using only

inquiry and analytical procedures. Most of the CPAs saw the review as a high risk engagement.

The use of an engagement letter was not a very common practice for many CPAs in the compilation engagement. Although it was used more frequently in the review, over 20% of the CPAs reported that they rarely or never used an engagement letter in a review.

Inquiry and analytical procedures are used in compilation and review engagements but much more frequently in a review as would be expected.

Although the CPAs rarely used audit-type procedures in a compilation, they "occasionally" to "frequently" used audit-type procedures in the review. Many considered this a necessity given the level of assurance.

The evidence presented suggests that SSARS has definitely created two separate and distinct categories of unaudited engagements worthy of different levels of assurance based on the differences in the work done by the CPAs in compilation and review engagements.

Bankers' Results

The following section is devoted to the research findings and implications concerning bankers.

Overview of the Banker Respondents

One hundred one Mississippi bank loan officers took part in this research effort. The bankers completed mailed questionnaires during the last two weeks in February and

the first two weeks in March, 1984. The questionnaire sent to the bankers can be found in Appendix B. The bankers' response rate was 62%.

Figure 4.8 presents an overview of the banker respondents. As can be seen from the figure, a large majority of the bankers (83%) indicated that they had reviewed during 1983 loan applications accompanied by CPA compiled and/or reviewed financial statements of a nonpublic entity. Some of the bankers had extensive experience with compiled and/or reviewed financial statements: 25.6% of those who indicated that they had experience with the statements indicated that they had reviewed more than 40 loan applications during 1983 accompanied by CPA compiled and/or reviewed financial statements.

It is apparent from Figure 4.8 that the bankers were located in cities of varied population sizes throughout the state: 19.2% reported that their banks were located in cities with populations of less than 10,000; 20.2% reported that their banks were located in cities with populations of more than 100,000.

A large majority of the bankers (82%) were less than 46 years old. In addition, the education level was high: 78% indicated that they had completed four or more years of college.

During the planning stage of this research the researcher found a surprising number of bankers unfamiliar

FIGURE 4.8
OVERVIEW OF THE BANKER RESPONDENTS

Compilation/Review Experience During 1983	Percent of Respondents	Loan Applications Reviewed During 1983 with Compiled or Reviewed Statements Attached	Percent of Respondents
Yes	83	Less than 10	30.2
		11 to 20	20.9
No	17	21 to 30	15.1
		31 to 40	8.1
		Over 40	25.6
TOTAL	100		100.0

Population of City in Which Bank Located	Percent of Respondents	Age of Respondents at Last Birthday	Percent of Respondent
Less than 1,000	4.0	Under 25	1.0
1,000 to 10,000	15.2	26 to 35	38.0
10,001 to 49,999	48.5	36 to 45	33.0
50,000 to 100,000	12.1	46 to 55	18.0
Over 100,000	20.2	Over 55	10.0
TOTAL	100.0		100.0

Highest Educational Level of Respondents	Percent of Respondents	Self-reported Familiarity with SSARS	Percent of Respondents
High School	9.0	(1) Not at all	46.9
Junior College	13.0	(2) *	16.3
Four Years of College	45.0	(3) Somewhat	29.6
More than Four Years of College	33.0	(4) *	5.1
		(5) Very	2.0
TOTAL	100.0		100.0

Importance Attached to the Bankers' Ability to Ascertain the Responsibility Taken by CPAs When CPA-prepared Statements are Submitted with a Loan Application	Percent of Respondents
(1) Not at all	1.5
(2) *	3.0
(3) Somewhat	16.4
(4) *	26.9
(5) Very	52.2
TOTAL	100.0

*Information solicited on a 1 to 5 point Likert-type scale.

Source: Original Data, 1984

with the terms "SSARS". However, all of the bankers consulted in the planning stage were familiar with CPA-prepared 'unaudited' financial statements. The bankers were asked to indicate their familiarity of SSARS in the final two questions in the bankers' questionnaire. A majority (53.1%) expressed some familiarity with SSARS; 46.9% reported that they were "Not At All" familiar with the topic. Such findings are surprising since 83% of the bankers indicated that they had reviewed loan applications during 1983 accompanied by compiled and/or reviewed financial statements of a nonpublic entity. It is apparent that some of the bankers looked upon compiled and reviewed statements as the same old unaudited statements that existed before SSARS.

The research findings are presented for the entire sample of bankers rather than just those who indicated that they were familiar with SSARS because: (1) after doing some follow-up interviews the researcher concluded that some of the bankers who indicated that they were not familiar with SSARS (the professional standards that govern compilations and reviews) were familiar with compilation and review services; (2) the participants were not selected at random. The questionnaires were distributed to the loan officers by an executive officer of the bank (in most cases the president) who had been briefed on the nature of the research and presented with a copy of the questionnaire. It is unlikely that the

questionnaires were distributed to individuals who were not familiar with compilation and review services or, at least, individuals that should have been familiar with the services. This theory is supported by the fact that 83% of the bankers indicated that they had reviewed loan applications during 1983 accompanied by compiled and/or reviewed financial statements.

Those respondents who indicated that they were not very familiar with SSARS were asked to indicate how important it is that the banking community be able to ascertain the responsibility taken by the CPA when financial statements (prepared by a CPA) are submitted along with a loan application. Figure 4.8 indicates that a majority of the bankers (95.5%) felt that it was "Somewhat" to "Very Important" that the banking community be able to ascertain the responsibility taken by the CPA when CPA-prepared statements are presented with a loan application.

In summary, the bankers used in this study consisted of highly-educated loan officers. An overwhelming majority (83%) had experience with unaudited financial statements during 1983 but only a slight majority (53.1%) reported that they were familiar with SSARS.

Overall Attitudes Towards SSARS

The bankers were asked to indicate their overall attitudes towards SSARS using a Likert-type one to five

point scale. Section I of the bankers' instrument was designed to solicit this information. Twelve statements were presented to the bankers covering: (1) Bankers' use of CPA-prepared statements in the credit-granting process, (2) Bankers' reactions to the changes made by SSARS and (3) Bankers' confidence in compiled and reviewed statements. The statements used to solicit the bankers' attitudes towards SSARS, the Likert-type scale, the percentage of respondents to select each answer and the mean responses are presented in Figure 4.9.

Overall, the bankers indicated that they made extensive use of CPA-prepared financial statements. Ninety-four percent agreed that unaudited statements play an important part in the credit-granting process in the banking community. Also, 89.1% agreed that their bank had a policy that required small business loan applications to be accompanied by compiled, reviewed or audited financial statements. It is interesting to note that some bankers indicated (in follow-up interviews) that revolutionary changes in the banking community were making it more difficult to demand CPA-prepared statements due to increased competition. Some small business loan customers, when asked for unaudited financial statements, shopped around in an attempt to find a bank that would approve the loan without the CPA-prepared statement. Most of the bankers noted, however, that a concentrated effort is made to get CPA-prepared financial statements when the

FIGURE 4.9
BANKERS' OVERALL ATTITUDES TOWARDS SSARS

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Use of CPA Prepared Statements</u>							
1	Unaudited Financial Statements (compiled and/or reviewed) play an important part in the credit granting process in the banking community.....	46.5	47.5	3.0	2.0	1.0	1.63
2	The bank with which I am employed has a policy that requires small business loan applications be accompanied by financial statements (compiled, reviewed or audited).....	73.3	15.8	2.0	4.0	5.0	1.51
3	I prefer that my small business loan customers submit Financial Statements (compiled, reviewed, or audited) when making application for a loan.....	83.2	12.9	3.0	.0	1.0	1.22
4	Financial Statements (compiled, reviewed or audited) prepared by CPAs are vital to the credit granting process at the bank with which I am employed.....	58.4	23.8	9.9	4.0	4.0	1.71
5	A knowledge of the owner(s) of the business overrides the need for any type of Financial Statement in the case of most small business loans.....	3.0	17.8	8.9	33.7	36.6	3.83
<u>Reactions to the SSARS Changes</u>							
6	The Division of unaudited statements into two categories by the accounting profession has led to a greater awareness on the part of the banking community of the degree of reliance to be placed on unaudited financial statements.....	17.8	40.6	27.7	11.9	2.0	2.39
7	The division of unaudited statements into two categories by the AICPA has confused the banking community on how much reliance can be placed on unaudited statements.....	5.9	32.7	24.8	26.7	9.9	3.02
8	The banking community has a better understanding of "unaudited financial statements" since the creation of compiled and reviewed services.....	15.8	42.6	27.7	11.9	2.0	2.41
9	By establishing compilation services, CPAs have professionalized an activity which is not professional work.....	5.0	34.0	40.0	18.0	3.0	2.30

FIGURE 4.9 (cont.)

BANKERS' OVERALL ATTITUDES TOWARDS SSARS

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Confidence in Unaudited Statements</u>							
10	Financial statements <u>compiled</u> by the CPA provide a reason- ably high degree of assurance that the statements are not false or misleading.....	12.9	29.7	13.9	23.8	19.8	3.07
11	Financial statements <u>reviewed</u> by the CPA provide a reason- ably high degree of assurance that the statements are not false or misleading.....	10.9	44.6	20.8	18.8	5.0	2.62
12	I still regard all unaudited statements to be about equal as related to reliability and do not distinguish between compiled and reviewed state- ments.....	7.9	28.7	15.8	34.7	12.9	3.15

*1=strongly agree; 2=mildly agree; 3=neutral; 4=mildly disagree;
5=strongly disagree

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984

loan request is sizeable and/or the applicant is not well known by the bank. When queried concerning the possibility of a knowledge of the owner(s) of a business to override the need for any type of financial statements, over 70% of the bankers disagreed that a knowledge of the owner(s) would override the need for any type of financial statements.

Figure 4.9 indicates that a slight majority of the bankers viewed SSARS as a positive development: 58.4% agreed that the SSARS split of unaudited statements into two categories (compiled/reviewed) has led to a greater awareness on the part of the banking community of the degree of reliance to be placed on unaudited financial statements; 58.4% agreed that the banking community has a better understanding of unaudited statements since the creation of compilation and review services.

Some of the bankers made comments regarding SSARS. Most of the comments praised the SSARS statements in general but made exceptions to selected aspects of SSARS. One banker stated:

I believe that the two new classifications are an attempt to create a better understanding between the banker and businessman, but I believe that they fall somewhat short. A category of unaudited needs to exist whereby the CPA verified at least accounts receivables and cash. If this was so, the term 'review' would take on a more prestigious meaning.

Other bankers indicated that the results of SSARS could be good if the accounting profession would do more to educate

the public on SSARS. One banker explained:

I feel that in general the accounting profession has not done a good job of educating the users of unaudited statements as to the meaning of compiled or reviewed financial statements or the responsibility of the accountants in preparing them.

In regard to bankers' confidence in unaudited statements, Figure 4.9 indicates that 42.6% of the bankers agreed that compiled financial statements provide a reasonably high degree of assurance that the statements are not false or misleading; 55.9% agreed that reviewed financial statements provide a reasonably high degree of assurance that the statements are not false or misleading. It is interesting to note, however, that 36.6% of the bankers agreed that they still regard all unaudited statements to be about equal as related to reliability and do not distinguish between compiled and reviewed statements.

In summary, the findings reveal that the banking community makes extensive use of compiled and reviewed financial statements in the credit-granting process. A majority of bankers felt that SSARS was a positive development in the accounting profession and had led to a greater understanding on the part of the banking community of 'unaudited' financial statements. However, some of the bankers expressed reservation about SSARS: some noted that the accounting profession has not done a good job in educating the public on SSARS; some noted that selected

confirmation and verification-type procedures should be required in all unaudited engagements, and 36.6% admitted that they do not distinguish between compiled and reviewed statements.

Perceptions of the CPAs' Responsibility To Use Selected Procedures in a Compilation

In section II-A of the bankers' questionnaire the bankers were asked to assume that experienced CPAs had been engaged to compile financial statements. Also, they were to assume that appropriate professional accounting standards governed the engagement.

The bankers were then given selected inquiry, analytical and audit procedures and asked to indicate their perceptions of the CPAs' responsibility to routinely perform the procedures in a compilation. The procedures, Likert-type scale, percentage of the bankers selecting each response and mean responses are given in Figure 4.10.

Inquiry. It is apparent from Figure 4.10 that the bankers expect the CPAs to ascertain that compiled financial statements are mathematically correct and that the financial statements and general ledger agree. Such perceptions are definitely within the scope of compilation services. A majority of the bankers (53%) also thought that the CPAs should inquire concerning the entity's accounting principles and practices and methods used in applying them in a compilation. Again, this is a

FIGURE 4.10

BANKERS' PERCEPTIONS OF THE CPAs' RESPONSIBILITY TO USE
SELECTED PROCEDURES IN A COMPILATION ENGAGEMENT

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Inquiry</u>							
1	Inquire concerning actions taken at meetings of the board of directors.....	8.9	15.8	14.9	13.9	46.5	3.73
2	Inquire concerning the entity's accounting principles and practices and the methods followed in applying them.....	30.0	23.0	13.0	12.0	22.0	2.73
3	Ascertain that the financial statements are mathematically correct.....	83.2	7.9	7.9	--	1.0	1.27
4	Ascertain that the financial statements and the general ledger are in agreements.....	64.4	9.9	10.9	2.0	12.9	1.89
<u>Analytical</u>							
5	Compare the current financial statements with prior year statements, when available	31.7	24.8	18.8	7.9	16.8	2.53
6	Perform ratio analysis and investigate significant fluctuations.....	12.9	20.8	16.8	11.9	37.6	3.40
<u>Audit</u>							
7	Confirm the cash balance directly with the bank.....	25.7	12.9	21.8	14.9	24.8	3.00
8	Observe the counting of the physical inventory.....	8.0	8.0	17.0	24.0	43.0	3.86
9	Evaluate the more important internal accounting controls..	22.8	17.8	15.8	16.8	26.7	3.06
10	Confirm the accounts receivable balance directly with debtors.....	7.9	14.9	17.8	14.9	44.6	3.73

*1=always; 2=frequently; 3=occasionally; 4=rarely; 5=never.

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984.

reasonable perception and probably a necessary inquiry in a compilation engagement. Although 60.4% of the bankers indicated that the CPAs rarely or never had a responsibility to inquire concerning action taken at the meeting of the board of directors in a compilation, 24.7% indicated that such an inquiry should always or frequently be done. Although it is probable that the CPA might make such an inquiry in compilation, such an inquiry is not routinely contemplated in a compilation engagement. In general, the analysis shows that the bankers did a good job in indicating the inquiry procedures associated with compilation services.

Analytical. Figure 4.10 indicates that a majority of the bankers (56.5%) felt that the CPA had a responsibility to always or frequently compare the current financial statements with the prior years' statements in a compilation. Approximately one-third indicated that the CPAs had a responsibility to perform ratio analysis and investigate significant fluctuations. Both analytical procedures presented in Figure 4.10 are commonly associated with compiled financial statements practically, but they are not mandated procedures per SSARS guidance. In theory, it must be concluded that some of the bankers' expectations were too high regarding the CPAs' responsibility to perform the procedures in a compilation.

Audit. The bankers' responses to the audit procedures listed in Figure 4.10 represented the first indication of a major void in some of the bankers' knowledge of compilation services: 38.6% indicated that the CPAs had a responsibility to always or frequently confirm the cash balance directly with the bank in a compilation; 40.6% indicated that the CPAs had a responsibility to always or frequently evaluate the more important internal accounting controls in a compilation and 22.8% indicated that the CPAs had a responsibility to always or frequently confirm the accounts receivable balance directly with debtors in a compilation. Such perceptions of the CPAs' responsibility in a compilation are clearly out of line with the expectations of SSARS. Only two of the four audit procedures in Figure 4.10 (observe the counting of the physical inventory and confirm the accounts receivable balance directly with debtors) received majority responses in the "Rarely" and "Never" categories combined--all four procedures should have received majority responses of "Rarely" and "Never" combined.

These results indicate that many bankers overestimated the CPAs' responsibility to use the traditional audit-type confirmation and verification procedures in a compilation engagement. Discussions with some of the bankers revealed that bankers like the traditional audit-type procedures and would like for CPAs

to perform such procedures in a compilation, regardless of the CPAs' responsibility.

Perceptions of the CPAs' Responsibility To Use Selected Procedures in a Review

In section II-B the bankers were asked to assume that experienced CPAs had been engaged to review financial statements. Also, they were told to assume that appropriate professional accounting standards governed the engagement.

The bankers used the same procedures given in section II-A (on the compilation of financial statement). They were asked to indicate their perceptions of the CPAs' responsibility to routinely perform the procedures when engaged to review financial statements. The procedures, Likert-type scale, percentage of the bankers selecting each response and mean responses are given in Figure 4.11.

Inquiry. Figure 4.11 indicates that some of the bankers responses regarding the CPAs' responsibility to use inquiry in a review engagement appear low. The bankers' perceptions of the CPAs' responsibility to inquire concerning actions taken at meetings of the board of directors (Number 1) and inquire concerning entity's accounting principles and practices and the methods followed in applying them (Number 2) are too low. Both inquiries are well within the scope of a review (in fact, suggested by SSARS). It is necessary that bankers

FIGURE 4.11

BANKERS' PERCEPTIONS OF THE CPAs' RESPONSIBILITY TO USE
SELECTED PROCEDURES IN A REVIEW ENGAGEMENT

Nos.	PROCEDURES	Percent Responses to Likert-type Scale*					Means
		(1)	(2)	(3)	(4)	(5)	
<u>Inquiry</u>							
1	Inquire concerning actions taken at meetings of the board of directors.....	13.9	11.9	28.7	21.8	23.8	3.29
2	Inquire concerning the entity's accounting principles and practices and the methods followed in applying them.....	33.7	32.7	16.8	7.9	8.9	2.25
3	Ascertain that the financial statements are mathematically correct.....	80.2	12.9	5.0	2.0	.0	1.28
4	Ascertain that the financial statements and the general ledger are in agreements.....	68.3	16.8	8.9	1.0	5.0	1.57
<u>Analytical</u>							
5	Compare the current financial statements with prior year statements, when available	30.7	38.6	17.8	5.9	6.9	2.19
6	Perform ratio analysis and investigate significant fluctuations.....	10.9	19.8	34.7	17.8	16.8	3.09
<u>Audit</u>							
7	Confirm the cash balance directly with the bank.....	25.3	24.2	23.2	10.1	17.2	2.69
8	Observe the counting of the physical inventory.....	6.0	13.0	26.0	23.0	32.0	3.62
9	Evaluate the more important internal accounting controls..	18.8	30.7	25.7	16.8	7.9	2.64
10	Confirm the accounts receivable balance directly with debtors.....	8.0	15.8	30.0	19.0	28.0	3.44

*1=always; 2=frequently; 3=occasionally; 4=rarely; 5=never.

Note: Percentages may not total 100% due to rounding.

Source: Original data, 1984.

understand the scope and nature of a review since a lack of understanding can result in a banker requesting that a client get audited financial statements when a review may be adequate.

Analytical. Again, some of the bankers' perceptions of the CPAs' responsibility to perform the two analytical procedures listed in Figure 4.11 are much too low for a review. SSARS charges the CPA to use analytical procedures to acquire limited assurances that there are no material modifications that should be made to the reviewed financial statements. The performance of ratio analysis and investigation of significant fluctuations (Number 6) is primary to the review of financial statements, yet only 30.7% of the bankers indicated that the CPA had a responsibility to always or frequently perform such an analysis in a review. In general, the analysis indicates that bankers are too conservative on the analytical procedure used in a review. The fairly large percentage of the bankers selecting the "Occasionally" response might be an indication of a lack of knowledge about the review.

Audit. Although SSARS No. 1 paragraph 29 states that a review does not contemplate a study and evaluation of internal accounting controls, tests of accounting records or responses to inquiries by obtaining corroborating evidential matter, many of the bankers felt that the CPAs had a responsibility to do so in a review. Figure 4.11

shows that 49.5% of the bankers felt that the CPAs had a responsibility to always or frequently confirm the cash balance directly with the bank in a review and 49.5% indicated that the CPAs had a responsibility to always or frequently evaluate the more important internal accounting controls. Only one of the audit procedures listed in Figure 4.11 received a majority response of "Rarely" and "Never" combined (observe the counting of the physical inventory). All four of the procedures should have had overwhelming responses of rarely and never.

These results indicate that many bankers, in general, are accustomed to the traditional audit-type procedures and expect the CPA to perform these procedures occasionally to frequently in the review engagement. The routine use of audit-type procedures is not contemplated by SSARS, but the earlier reported research findings on the CPAs indicated that some CPAs do routinely use audit-type procedures in the review. At this point it may be concluded that the bankers' perceptions of the CPAs' responsibility to use audit-type procedures in a review exceed the level contemplated by SSARS. Later, it will be discussed how these expectations compare to what practitioners actually do in practice in a review engagement.

Comparison of the Compilation with the Review

A comparison between bankers' perceptions of the CPAs' responsibility to perform selected procedures in a compilation and review is presented in Figure 4.12. The measure of statistical significance used in Figure 4.12 is based on the t-statistic. At $\alpha = .05$ the last column of Figure 4.12 (two-tail probability) shows a significant difference between the bankers' perceptions regarding the compilation and review for six of the ten procedures.

Three of the four inquiry procedures listed in Figure 4.12 showed a significant difference between the bankers' perceptions of the CPAs' responsibility to perform the procedures in the compilation as compared to the review engagement. The only inquiry procedure that failed to show a significant difference in perceptions was the CPAs' responsibility to ascertain that the financial statements are mathematically correct. This is not surprising since such a procedure would always be expected of any reputable CPA. In general, the lower review means indicate that the bankers perceived a greater responsibility on the part of the CPAs to inquire in a review engagement (since the means were computed using the Likert-type scale of 1 = CPAs' always have the responsibility to perform the procedure; 5 = CPAs never have the responsibility to perform the procedure). Such findings are positive for the banking community.

FIGURE 4.12

COMPARISON OF BANKERS' PERCEPTIONS OF THE CPAs' RESPONSIBILITY
TO USE SELECTED PROCEDURES IN A COMPILATION
ENGAGEMENT WITH A REVIEW ENGAGEMENT

Nos.	PROCEDURES	Compilation Means	Review Means	Two-tail Probability
<u>Inquiry</u>				
1	Inquire concerning actions taken at meetings of the board of directors.....	3.73	3.29	.003*
2	Inquire concerning the entity's accounting principles and practices and the method followed in applying them.....	2.73	2.25	.002*
3	Ascertain that the financial statements are mathematically correct.....	1.27	1.28	.843
4	Ascertain that the financial statements and the general ledger are in agreement.....	1.89	1.57	.004*
<u>Analytical</u>				
5	Compare the current financial statements with prior year statements, when available	2.53	2.19	.015*
6	Perform ratio analysis and investigate significant fluctuations.....	3.40	3.09	.043*
<u>Audit</u>				
7	Confirm the cash balance directly with the bank.....	3.0	2.69	.053
8	Observe the counting of the physical inventory.....	3.86	3.62	.064
9	Evaluate the more important internal accounting controls.	3.06	2.64	.003*
10	Confirm the accounts receivable balance directly with debtors.....	3.73	3.44	.073

Note: Means are computed using the Likert-type scale (1=always, 5=never).

*Differences are statistically significant

Source: Original data, 1984.

Both of the analytical procedures in Figure 4.12 showed a significant difference between the bankers' perceptions of the CPAs' responsibility to use the procedures in the compilation as compared with the review. Again, these findings are positive for the banking community. The findings suggest that the bankers do perceive a difference in the CPAs' responsibility in compilation and review services, and bankers perceive a greater responsibility in the review than in the compilation (since the review means are lower).

The auditing procedures listed in Figure 4.12 are more difficult to analyze since, in theory, audit-type procedures are not contemplated by SSARS in the compilation or review. As such, the compilation and review means for the auditing procedures should have been high (4 = Rarely, 5 = Never). However, previous findings indicated that bankers expect some audit-type procedures to be performed in accounting and review services and CPAs' do use some auditing procedures. A lack of a significant difference for audit procedures 7, 8 and 10 (Figure 4.12) is not positive since it indicates that many bankers expect the CPAs to occasionally perform confirmation and verification-type procedures in unaudited services and they do not distinguish between the compilation and review.

However, previous findings indicated that many CPAs do in fact use confirmation and verification type

procedures in the review but not in the compilation. As such, these findings represent a major problem in bankers' perceptions of compilation only. Additional analysis is needed to interpret the review findings.

Summary

This section has presented the major research findings and implications concerning the bankers.

The findings indicated that a majority of the bankers viewed SSARS as a positive development in the accounting profession: many of the bankers felt that the accounting profession had not done a very good job in educating the public on SSARS and many of the bankers admitted that they were not very familiar with SSARS. The bankers made extensive use of compiled and/or reviewed statements in the credit-granting process. More than thirty-six percent of the bankers agreed that they still regard all unaudited statements to be about equal as related to reliability and do not distinguish between compiled and reviewed statements.

In general, the bankers' findings indicated that they understood the limited use of inquiry and analytical procedures in a compilation but overestimated the CPAs' responsibility to use audit-type procedures in a compilation. The bankers' perceptions were too low in regard to the CPAs' responsibility to use inquiry and analytical procedures in a review but overestimated the

CPAs' responsibility to use audit-type procedures in a review (as compared to SSARS guidance): the next section compares the bankers' perceptions to what practitioners actually do in compilation and review services.

Comparison of the CPAs' Use of Select Procedures
in Unaudited Engagements with Bankers' Per-
ceptions of the CPAs' Responsibility
to Use the Procedures

Since CPAs are the preparers and bankers are the major third party users of compilations and reviews, it is very important that the two groups have mutual perceptions of the CPAs' responsibility to perform certain procedures in compilation and review services. All ten of the procedures that appeared on the bankers' questionnaire also appeared on the CPAs' questionnaire. The next section is devoted to a comparison of the CPAs' use of selected procedures in compilations and reviews with bankers' perceptions of the CPAs' responsibility to use the procedures in compilations and reviews.

The Compilation Engagement

A comparison of the frequency with which the CPAs used selected procedures in a compilation with bankers' perceptions of the CPAs' responsibility to use the procedures is presented in Figure 4.13. The measure of statistical significance for Figure 4.13 is based on the t-statistic. At $\alpha = .05$ the last column of Figure 4.13 (two-tail probability) shows that the differences are significant for nine of the ten procedures.

FIGURE 4.13

COMPARISON OF THE CPAs' USE OF SELECTED PROCEDURES IN A
 COMPILATION WITH BANKERS' PERCEPTIONS OF THE CPAs'
 RESPONSIBILITY TO USE THE PROCEDURES

Nos.	PROCEDURES	Bankers' Means	CPAs' Means	Two-tail Probability
<u>Inquiry</u>				
1	Inquire concerning actions taken at meetings of the board of directors.....	3.73	3.16	.005*
2	Inquire concerning the entity's accounting principles and practices and the method followed in applying them.....	2.73	1.76	.000*
3	Ascertain that the financial statements are mathematically correct.....	1.27	1.06	.007*
4	Ascertain that the financial statements and the general ledger are in agreement.....	1.89	1.15	.000*
<u>Analytical</u>				
5	Compare the current financial statements with prior year statements, when available	2.53	1.74	.000*
6	Perform ratio analysis and investigate significant fluctuations.....	3.40	3.06	.084
<u>Audit</u>				
7	Confirm the cash balance directly with the bank.....	3.0	3.89	.000*
8	Observe the counting of the physical inventory.....	3.86	4.47	.000*
9	Evaluate the more important internal accounting controls.	3.06	3.54	.016*
10	Confirm the accounts receivable balance directly with debtors.....	3.73	4.52	.000*

Note: Means are computed using the Likert-type scale (1=always, 5=never).

*Differences are statistically significant

Source: Original data, 1984.

The only procedure that failed to show a significant difference was the performance of ratio analysis and investigation of significant fluctuations.

A review of Figure 4.13 reveals that for all the inquiry and analytical procedures that showed a significant difference, the CPAs' means are lower. Since the means were computed using the Likert-type scale of 1 = Always and 5 = Never, the results indicate that the bankers are more conservative than the CPAs regarding CPAs' actual use of inquiry and analytical procedures in a compilation. As such, bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedures in a compilation is not overestimated. These findings are positive for the banking community.

Figure 4.13 shows that the results are not as impressive on the audit procedures: in all cases the CPAs' means are higher than the bankers' means. This suggests that the bankers' perceptions of the CPAs' responsibility to use the procedures in a compilation exceed the CPAs' actual use of the procedures. In general, the bankers viewed the CPAs' responsibility to use the audit procedures in the "Occasionally" to "Rarely" range whereas the CPAs reported using the procedures "Rarely" to "Never". This analysis indicates that the bankers' perceptions of the CPAs' responsibility to perform the audit-type procedures in a compilation exceed the CPAs' actual use of the procedures when the

practitioners were engaged to prepare compiled financial statements during 1983. Previously, analysis has shown that the bankers' perceptions of the CPAs' responsibility to use audit-type procedures in a compilation exceeded that level contemplated by SSARS. The findings suggest that the bankers' perceptions of the CPAs' responsibility to use audit-type procedures in a compilation exceed that level established by SSARS and exceed the level at which practitioners actually perform.

The Review Engagement

A comparison of the frequency with which the CPAs used selected procedures in a review with bankers' perceptions of the CPAs' responsibility to use such procedures is presented in Figure 4.14. The measure of statistical significance for Figure 4.14 is based on the t-statistic.

At $\alpha = .05$ the last column of Figure 4.14 (two-tail probability) shows that there is a significant difference between the means for each of the inquiry and analytical procedures. Again, the bankers' means are much higher than the CPAs' means. This suggests that the CPAs used the inquiry and analytical procedures much more than it was perceived by the bankers. Although the bankers are more conservative on the use of inquiry and analytical procedures in a review, this cannot be classified as a totally positive finding since SSARS charges the CPA to

FIGURE 4.14

COMPARISON OF THE CPAs' USE OF SELECTED PROCEDURES IN A
REVIEW WITH BANKERS' PERCEPTIONS OF THE CPAs'
RESPONSIBILITY TO USE THE PROCEDURES

Nos.	PROCEDURES	Bankers' Means	CPAs' Means	Two-tail Probability
<u>Inquiry</u>				
1	Inquire concerning actions taken at meetings of the board of directors.....	3.29	1.87	.000*
2	Inquire concerning the entity's accounting principles and practices and the method followed in applying them.....	2.25	1.29	.000*
3	Ascertain that the financial statements are mathematically correct.....	1.28	1.03	.000*
4	Ascertain that the financial statements and the general ledger are in agreement.....	1.57	1.05	.000*
<u>Analytical</u>				
5	Compare the current financial statements with prior year statements, when available	2.19	1.40	.000*
6	Perform ratio analysis and investigate significant fluctuations.....	3.09	2.06	.000*
<u>Audit</u>				
7	Confirm the cash balance directly with the bank.....	2.69	2.83	.528
8	Observe the counting of the physical inventory.....	3.62	3.75	.471
9	Evaluate the more important internal accounting controls.	2.64	2.69	.784
10	Confirm the accounts receivable balance directly with debtors.....	3.44	3.85	.027*

Note: Means are computed using the Likert-type scale (1=always, 5=never).

*Differences are statistically significant

Source: Original data, 1984.

express limited assurance in the review based primarily on inquiry and analytical procedures. These findings indicate that many bankers are not totally aware of the nature of the assurance provided by the review.

Figure 4.14 indicates very impressive results regarding the audit procedures. At $\alpha = .05$ one cannot say that the CPAs' actual use of the audit-type procedures differed significantly from the bankers' perceptions of the CPAs' responsibility to use the procedures for three of the four procedures. This analysis suggests that bankers' perceptions of the CPAs' responsibility to use audit-type procedure in a review and the CPAs' actual use of audit-type procedure in a review do not differ significantly. This lessens the threat of any expectation gap between CPAs and bankers on the review of financial statements.

Summary

This final section has presented a comparison between the bankers' perceptions of the CPAs' responsibility in unaudited engagements and what practitioners actually do in unaudited engagements.

The analysis suggested that an expectation gap existed in the compilation engagement in two forms: (1) the bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedures in a compilation

were too low; (2) the bankers expected too much in regard to the use of audit-type procedures in a compilation.

In regard to the review engagement, the analysis suggested: (1) again, the bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedure in a review were too low; (2) bankers and CPAs do not differ on their perceptions of the extent to which audit-type procedures are used in the review.

CHAPTER V

SUMMARY, RECOMMENDATIONS, AND CONCLUSIONS

This chapter summarizes the research findings presented in chapter four. Recommendations and conclusions are also included.

Summary of Findings

The revolutionary changes brought about by SSARS has caused CPAs and bankers to adjust to a host of departures from the traditional thinking on unaudited financial statements. These changes were necessary to: (1) inform users of unaudited statements of the nature and scope of unaudited services and, (2) attempt to limit the CPAs' legal exposure in unaudited engagements. SSARS divided the previous wide array of scarcely defined unaudited services for nonpublic entities into two better defined services: compilation and review. Also, descriptive reports with different levels of assurance replaced the previously used disclaimer of opinion.

The purpose of this research was to gain a better understanding of Mississippi CPAs' and bankers' attitudes towards SSARS. Specifically, the research attempted to answer these questions: (1) What are the overall attitudes of Mississippi CPAs and bankers towards SSARS;

- (2) What type of procedures are Mississippi CPAs using in compilation engagements and what are the overall perceptions of Mississippi bankers of compiled statements;
- (3) What type of procedures are Mississippi CPAs using in review engagements and what are the overall perceptions of Mississippi bankers of reviewed statements.

Ninety-five Mississippi resident CPAs engaged in public practice and 101 Mississippi bank loan officers participated in this study. The primary data collection method was mailed questionnaires. Personal interviews served as a secondary data collection source. The following sections summarize the major findings concerning the CPAs and bankers.

CPAs

The CPAs were queried on their overall attitudes towards SSARS, their use of selected procedures in a compilation, and their use of selected procedures in a review.

Overall Attitudes Towards SSARS. A substantial majority of the CPAs felt that SSARS represents a positive development in public accounting practice. However, it is interesting to note that more CPAs disagreed than agreed that their clients have a better understanding of the services they are obtaining in compilation and review services compared to previous "unaudited" services.

Although more practitioners agreed than disagreed that SSARS has led to a decrease in the CPAs' legal exposure in unaudited engagements, the margin was not wide. Those who felt that SSARS has led to a decrease in practitioners' legal exposure did not represent a majority since many of the CPAs were neutral on the issue. It was found that most of the practitioners did not feel that the legal exposure in accounting engagements moves directly with the level of assurance (i.e., compilation, review, audit). A large majority felt that the legal exposure in a review is greater than the legal exposure in an audit.

A majority of the practitioners did not think that SSARS contains too many specific standards and procedures on the compilation or review of financial statements. In fact, many of the comments and interviews led the researcher to believe that most practitioners desire additional guidance on the review of financial statements. Many of the practitioners stated that more guidance is needed on the nature and scope of the procedures to be used in a review when inquiry and analytical procedures fail to provide the CPA with the limited assurance contemplated by the review report. Although most of the practitioners stated that they used audit-type procedures in such an instance, most were hesitant to use the procedures due to possible additional legal exposure and the lack of specific guidance by SSARS on the use of audit-type procedures in a review.

A small percentage of the CPAs reported movements from audits to compilations and/or reviews. Such movements were anticipated by some practitioners since the review is in some cases an acceptable alternative to an audit for some nonpublic clients. In general, the practitioner did not recommend shifts from audits to reviews or compilations since: (1) compilation and review services do not normally include a complete study and evaluation of internal controls and are not likely to promote operational efficiency as well as an audit, (2) the audit is a more comprehensive service than the compilation or review and is more likely to result in the detection of error or irregularities.

Use of Selected Procedures in a Compilation. The use of a procedures checklist was very common among CPAs in a compilation engagement, and about one-fourth of the practitioners indicated that they always or frequently obtained management representations in a compilation. However, it is interesting to note that less than a majority of the CPAs reported that they always or frequently used an engagement letter in a compilation engagement.

Inquiry was found to be very common in a compilation engagement. An overwhelming majority of the CPAs reported that they always or frequently ascertained that the compiled financial statements were mathematically correct

and agreed with the general ledger. A large majority of the CPAs also indicated that they always or frequently inquired concerning the entity's accounting principles and practices, and reviewed the statements with the client before issuing the compilation report. An inquiry concerning actions taken at meetings of the board of directors was not frequently done by the practitioners in a compilation.

In general the results showed that practitioners did not use analytical procedures extensively in a compilation. However, some limited comparisons were usually done in an attempt by the CPAs to spot items that were out-of-line. A comparison of the current year's financial statements with prior years' statements was always or frequently done by over 80% of the practitioners.

Overall, audit-type procedures were not routinely used by practitioners in compilation engagements. However, 11.6% of the CPAs reported that they always or frequently confirmed the cash balance directly with the bank in a compilation, and 18.9% reported that they always or frequently evaluated the more important internal accounting controls in a compilation. In the follow-up interview process most of the CPAs stated that they would question the routine use of any audit-type procedures in a compilation due to the possibility of increased legal exposure.

Use of Selected Procedures in a Review. The use of a procedures checklist was very common in review engagements. Also, approximately three-fourths of the practitioners indicated that they always or frequently obtained management representations in a review. However, about one-third of the practitioners reported that they did not always or frequently use an engagement letter in a review. In general, it was concluded that the use of an engagement letter was not very common among some practitioners before SSARS and these practitioners will not use an engagement letter unless it is required.

Overall, all of the inquiry-type procedures used in the study were always or frequently used in review engagements. In general, the researcher concluded that in a review most of the practitioners inquired concerning most of the items or matters verified in an audit. Some of the CPAs noted that they used inquiry-type questionnaires in a review. Those items identified by the inquiry questionnaire (or analytical procedures) as problem areas were targeted for additional investigation.

Two of the four analytical procedures used in the research were used always or frequently by an overwhelming majority of the practitioners. These included a comparison of the reviewed statements of the current year with prior years' statements, and the performance of ratio analysis with investigation of significant fluctuations. A slight majority reported that they always or frequently

compared the current statements with anticipated results. A comparison of the reviewed entity's ratios with industry ratios was not done very often by most of the practitioners. It was concluded that it is not easy to find comparable industry ratios for many review clients.

The extent to which the CPAs used selected audit-type procedures in a review engagement was surprising: A majority of the CPAs reported that they always or frequently confirmed cash directly with the bank, and evaluated the more important internal accounting controls. In addition, about one-fifth of the practitioners reported they always or frequently observed the physical inventory count, and confirmed the accounts receivable balance directly with debtors in a review. The basic explanation given was that the procedures are necessary in some instances to achieve limited assurance.

Comparison of the Compilation with the Review. When the frequency with which the CPAs routinely used the selected procedures in a compilation was compared with the frequency with which they routinely used the procedures in a review a significant difference existed for nearly all of the procedures. In general the procedures were used more frequently in a review. These findings suggested that SSARS has been successful in creating two classes of unaudited statements with different levels of assurance warranted by the different reports.

Bankers

The bankers were queried on their overall attitudes towards SSARS and perceptions of the CPAs' responsibility to perform selected procedures in compilations and reviews.

Overall Attitudes Towards SSARS. An overwhelming majority of the bankers said that unaudited financial statements played an important part in the credit-granting process and that they had reviewed financial statements during 1983 accompanied by compiled and/or reviewed financial statements of a nonpublic entity. However, it was interesting to note that only a slight majority of the bankers indicated that they were familiar with SSARS. One major reason for this lack of familiarity on the part of many of the bankers could be their overall attitude concerning unaudited financial statements: over one-third of the bankers indicated that they regard all unaudited statements to be about equal as related to reliability and do not distinguish between compiled and reviewed statements.

A slight majority of the bankers agreed that the banking community has a better understanding of unaudited statements since the creation of compilation and review services. But, more than one-third of the bankers indicated that the SSARS division of unaudited statements into two categories has confused the banking community on

how much reliance can be placed on the statements. Many of the bankers felt that the accounting profession had not done a good job of educating the public on the different levels of assurance and types of opinions created by SSARS.

Fifty-five percent of the bankers agreed that a review provides a reasonably high degree of assurance that the financial statements are not false or misleading; 42% agreed that a compilation provides a reasonably high degree of assurance that the statements are not false or misleading. The lack of a large percentage difference between the percentage that agreed that a compilation provides a reasonably high degree of assurance that the financial statements are not false or misleading and the percentage that agreed that a review provides a reasonably high degree of assurance that the statements are not false or misleading suggests that many bankers feel that it is the CPAs' association that adds most of the credibility to unaudited statements--not the type of unaudited engagement. Otherwise, one would have expected the percentage difference to be much larger since a compilation does not result in any expression of opinion but the review results in the expression of limited assurance.

Perceptions of a Compilation. The bankers did not have great expectations concerning CPAs' responsibility to use inquiry and analytical procedures in a compilation.

Given that a compilation does not result in any expression of assurance and the CPAs' limited responsibility in a compilation, the bankers' perceptions are acceptable.

When the bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedures in a compilation were compared to the CPAs' indication of the frequency with which they actually used the same inquiry and analytical procedures in a compilation a significant difference was found between the two groups for six of the seven procedures. In all instances the CPAs reported using the procedures more frequently than the bankers indicated that they had a responsibility to use the procedures. Such findings are positive for the banking community since they indicate that bankers do not place undue reliance on the CPAs' responsibility to use inquiry and analytical procedures in a compilation.

The results were not as impressive regarding the bankers' perceptions of the CPAs' responsibility to use audit-type procedures in a compilation: over one-third of the bankers indicated that the CPAs had a responsibility to always or frequently confirm the cash balance with the bank, and evaluate the more important internal accounting controls in a compilation. In addition, 16% of the bankers indicated that the CPAs had a responsibility to always or frequently observe the counting of the physical inventory, and over one-fourth indicated that the CPAs had a responsibility to always or frequently confirm the

accounts receivable balance directly with debtors in a compilation. These expectations are well beyond those contemplated by SSARS. When the bankers' perceptions were compared with the frequency with which the CPAs indicated that they used the audit-type procedures in a compilation, a significant difference was found between the two groups for all four of the audit-type procedures that appeared on both the CPAs' and bankers' questionnaires. In all instances the bankers' overall perceptions of the CPAs' responsibility to use the audit-type procedures exceeded the CPAs' indication of the frequency with which they used the procedures. In general, this analysis suggests that a slight expectation gap existed between the CPAs and bankers concerning the use of audit-type procedures in a compilation.

Perceptions of a Review. Many of the bankers did not perceive that CPAs had a responsibility to always or frequently use inquiry and analytical procedures in a review. This suggested a lack of knowledge by the bankers since inquiry and analytical procedures are the foundation of a review. When the bankers' perceptions regarding the CPAs' responsibility to use inquiry and analytical procedures in a review were compared with the CPAs' indications of the frequency with which they use inquiry and analytical procedures in a review, a significant difference was found for all seven procedures. In all instances the CPAs

indicated that they used the procedures more frequently than the bankers thought the CPAs had a responsibility to use the procedures. While these findings indicated that bankers do not place undue reliance on the CPAs' responsibility to use inquiry and analytical procedures in a review, they may also be an indication of a lack of knowledge on the part of the banking community concerning the nature of the assurance provided by a review: limited assurance provided primarily through inquiry and analytical procedures.

Overall, the bankers clearly expected that the CPAs had a responsibility to occasionally or frequently use audit-type procedures in a review; about one-half of the bankers indicated that the CPAs had a responsibility to always or frequently confirm the cash balance directly with the bank, and evaluate the more important internal accounting controls in a review. In addition, 18% to 23% respectively felt that the CPAs had a responsibility to always or frequently observe the counting of the physical inventory and confirm the accounts receivable balance directly with debtors in a review. In theory these expectations appeared to surpass the CPAs' responsibility in a review as established by SSARS. However, when the bankers' perceptions regarding the audit-type procedures were compared with the CPAs indication of the frequency with which they routinely used the procedures in a review, a significant difference was not found in three of the

four procedures. This analysis suggested that in most cases bankers' perceptions of the CPAs' responsibility to use audit-type procedures in a review did not differ significantly from the actual use of audit-type procedures in a review by CPAs. Practically speaking, these findings suggested that bankers do not place undue reliance on the CPAs actual use of audit-type procedures in a review. However, on a more theoretical level, the analysis suggested that the bankers' expectations were too great and the CPAs used audit-type procedures more frequently than contemplated by SSARS since SSARS clearly states that a review does not routinely entail the traditional audit-type verification and confirmation procedures.

Comparison of the compilation with the review. When the bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedures in a compilation were compared with the bankers' perceptions of the CPAs' responsibility to use inquiry and analytical procedures in a review, a significant difference was found for six of the seven procedures. In all instances in which differences were found the bankers' perceptions of the CPAs' responsibility to use the procedures in a review were greater than their perceptions of the CPAs' responsibility to use the procedures in a compilation. These findings suggested that the bankers did distinguish between the CPAs' responsibility in compilation and review

services, and the bankers perceived a greater responsibility in a review than in a compilation. Such findings are positive for the banking community.

When the bankers' perceptions of the CPAs' responsibility to use audit-type procedures in compilation and review services were compared, a significant difference was indicated for only one of the four audit-type procedures that appeared on the questionnaire. These findings suggested that bankers do not distinguish between the CPAs' responsibility to use audit-type procedures in compilation and review services in many instances. Such findings are not positive since previous findings indicated that bankers perceived a responsibility on the part of the CPAs to use the audit-type procedures, occasionally to frequently in many instances, in compilation and review services. Such findings suggest that many bankers are accustomed to the traditional audit-type procedures and expect CPAs to use these procedures any time the CPAs are associated with financial statements, regardless of the kind of engagement.

Recommendations and Conclusions

The AICPA's decision to issue separate standards on the unaudited financial statements of nonpublic entities was viewed as a major step to clarify CPAs' responsibility in unaudited engagements. This clarification was needed

to protect practitioners from undue legal exposure and to provide better services to users of unaudited statements.

This research suggests that most Mississippi CPAs and bankers view SSARS as a positive development in public accounting practice. However, some problems were revealed. To help eliminate some of these problems and therefore derive the maximum benefits from SSARS the following recommendations are made concerning the CPAs, bankers, and future research.

Recommendations Concerning CPAs

The Mississippi Society of CPAs and other state accounting groups should make sure that adequate continuing professional education seminars are offered in the state on compilation and review services. In addition, Mississippi CPAs in public practice should be encouraged to attend these seminars.

These seminars should emphasize: (1) the need for an engagement letter in all compilation and review engagements, (2) the wide array of analytical procedures available for use in the review engagements and the technical knowledge needed to select and interpret the analytical procedures for different situations.

Practitioners must also be reminded that the routine use of audit-type procedure is not contemplated by SSARS. Therefore, those who routinely use such procedures in compilation and review services should take a closer look

at this policy since the result could be additional legal exposure. Since SSARS calls for practitioners to perform additional procedures in accounting and review services if they become aware of incorrect or incomplete information, the periodic use of audit-type procedures in compilation and review engagements may be a necessity. Therefore the best method(s) to document the use of audit-type procedure in compilation and review services should be incorporated into all continuing professional education seminars on unaudited financial statements.

Finally, Mississippi CPAs should attempt to increase clients' awareness, the Mississippi banking community's awareness, and the public's awareness in general of the different levels of assurance and reports covered by SSARS. Formal and informal interaction is encouraged between the state's CPAs and bankers to minimize any expectation gap that may exist on compilation and review services.

Recommendations Concerning Bankers

It is imperative that the Mississippi Bankers Association and other state banking groups integrate sessions regarding SSARS into their continuing education programs. The continuing professional education seminars should emphasize the different levels of assurance available (compilation, review, audit) and the differences in the scope of the engagements.

These seminars should emphasize that the routine use of audit-type procedure is not contemplated in compilations or reviews and that bankers should not assume that such procedures are used in the engagements.

After studying the different levels of assurance available, banks should evaluate their policies concerning financial statements that accompany loan applications and set parameters on the level of assurance desired for loans with specified characteristics.

Finally, the Mississippi banking community should attempt to arrange for formal and informal interactions with the Mississippi public accounting community. Ideas should be exchanged on accounting and review services. The results should help minimize any expectations gap between the groups on compilation and review services.

Future Research

This research suggested that there is a need for additional research regarding unaudited financial statements in two major areas.

First, this research suggested that the routine use of audit-type procedures is not uncommon in the review engagement. Since SSARS does not contemplate the routine use of audit-type procedures in the review, further research is needed to determine if it is reasonable to expect that CPAs will normally be able to express limited assurance in the review based primarily on inquiry and

analytical procedures. If not, additional guidance is needed on the use of audit-type procedures in the review.

Second, since SSARS does anticipate that "additional procedures" may occasionally be needed in accounting and review services (and it appears that most practitioners use audit-type procedures for these additional procedures) legal research is needed concerning CPAs' documentation of the use of these procedures in the most effective way(s) to protect practitioners from the additional legal expenses that may arise from the use of audit-type procedures in accounting and review service engagement.

Summary of Chapter

This chapter has presented the major research findings and implications in summary form. Recommendations and conclusions are also included.

The revolutionary changes brought about by SSARS have caused CPAs and bankers to adjust to a host of departures from the traditional thinking on unaudited financial statements. CPAs and bankers tend to feel that the SSARS changes represent a positive development in public accounting practice.

CPAs use a wide variety of procedures in compilation and review services. Bankers perceive that CPAs use a wide variety of procedures in compilation and review services. While in some instances the CPAs and bankers surveyed in this research held similar opinions regarding

the extent to which selected procedures should be used in compilation and review services, in other instances the opinions differed significantly.

Additional continuing professional education on SSARS would be useful to CPAs and bankers. By taking advantage of additional continuing professional education concerning SSARS, CPAs and bankers will be in a better position to derive all of the benefits intended by the changes in unaudited financial statements brought about by SSARS.

APPENDIX A
CPA QUESTIONNAIRE

MISSISSIPPI STATE UNIVERSITY • COLLEGE OF BUSINESS AND INDUSTRY
SCHOOL OF ACCOUNTANCY

Dear Mississippi CPA:

Since the Accounting and Review Services Committee began issuing Statements on Standards for Accounting and Review Services (SSARS), professional standards on unaudited financial statements have become an integral part of the practice of public accounting. To date, however, there continues to be much discussion of SSARS and unaudited financial statements.

I am currently conducting a survey to determine the perception of Mississippi CPAs concerning SSARS and the procedures commonly associated with compiled and reviewed financial statements. This research effort is endorsed by Dr. Louis Dawkins, Director of the School of Accountancy at Mississippi State University. Your participation in this survey by filling out the enclosed questionnaire and returning it in the self-addressed stamped envelope as soon as possible would be greatly appreciated.

The code number listed on your questionnaire will be used for control purposes only. All responses will remain confidential and will be used in tabulations only. I certainly appreciate your help and look forward to receiving your response.

Sincerely,

Quinton Booker

Quinton Booker, CPA
Doctoral Candidate

L E Dawkins

Dr. Louis Dawkins, Ph.D., CPA
Professor and Director of the School of Accountancy
Endorsement

P.S. Please attempt to answer all questions.

I. Each of the following 12 statements refer to Statements on Standards for Accounting and Review Services (SSARS). Please indicate your response to each by circling one response per question. The following responses are available.

	(1)	(2)	(3)	(4)	(5)
	Strongly Agree	Mildly Agree	Neutral	Mildly Disagree	Strongly Disagree
1. Overall, SSARS represents a positive development in the practice of Public Accounting.....	1	2	3	4	5
2. The <u>Compilation</u> of Financial Statements is a Professional Accounting Service and the establishment of standards to cover such a service is good for public accounting practice.....	1	2	3	4	5
3. The issuance of SSARS has led to a decrease in legal exposure when the CPA is associated with unaudited financial statements of the nonpublic entity.....	1	2	3	4	5
4. There are too many specific standards and procedures included in SSARS on the <u>compilation</u> of financial statements.....	1	2	3	4	5
5. There are too many specific standards and procedures included in SSARS on the <u>review</u> of financial statements.....	1	2	3	4	5
6. The Accounting and Review Services Committee erred when they recognized the <u>compilation</u> of financial statements as a professional accounting service and established standards to cover compilation engagements.....	1	2	3	4	5
7. Many of the nonpublic clients that my firm once audited have substituted compilations and/or reviews since the issuance of SSARS.....	1	2	3	4	5
8. The risk of legal exposure is greater with a review engagement than with an audit engagement.....	1	2	3	4	5
9. The risk of legal exposure is greater with a review engagement than with a compilation engagement.....	1	2	3	4	5
10. The procedures mentioned by SSARS as appropriate for a compilation engagement are not adequate: In most instances additional procedures not contemplated by SSARS are necessary to achieve the degree of assurance intended in the Standard Compilation Report.....	1	2	3	4	5
11. My clients have a better understanding of the services they are obtaining in compilation or review engagements, compared to previous unaudited engagements.....	1	2	3	4	5
12. The review procedures mentioned by SSARS as appropriate for a review engagement are not adequate and in most instances audit type procedures not contemplated by SSARS are necessary to achieve a degree of confidence intended by the Standard Review Report.....	1	2	3	4	5

II. For each of the following procedures please indicate:

- (1) In CATEGORY A the frequency with which you or your firm routinely used the given procedures when engaged to compile financial statements during 1983.
- (2) In CATEGORY B the frequency with which you or your firm routinely used the given procedure when engaged to review financial statements during 1983.

If you are unaware of your firms' policy or were not engaged to compile and/or review financial statements during 1983, answer each question based on your perception of the extent to which you would have used the procedure had you been engaged to compile and/or review financial statements during 1983. Circle one response per question in each category. The following responses should be used:

- (1) ALWAYS
- (2) FREQUENTLY
- (3) OCCASIONALLY
- (4) RARELY
- (5) NEVER

PROCEDURES	CATEGORY A compilation engagement					CATEGORY B review engagement				
	1	2	3	4	5	1	2	3	4	5
13-14 Used an engagement letter	1	2	3	4	5	1	2	3	4	5
15-16 Obtained management representations.	1	2	3	4	5	1	2	3	4	5
17-18 Used some sort of procedures "checklist"	1	2	3	4	5	1	2	3	4	5
19-20 Inquire concerning the entity's accounting principles and practices and the methods followed in applying them.....	1	2	3	4	5	1	2	3	4	5
21-22 Ascertained that the financial statements were mathematically correct	1	2	3	4	5	1	2	3	4	5
23-24 Ascertained that the financial statements and the general ledger were in agreement	1	2	3	4	5	1	2	3	4	5
25-26 Reviewed the statements with the client before rendering the report.	1	2	3	4	5	1	2	3	4	5
27-28 Compared the current statements with anticipated results (budgets or forecasts) when available	1	2	3	4	5	1	2	3	4	5
29-30 Compared the current statements with prior year statements, when available	1	2	3	4	5	1	2	3	4	5
31-32 Computed ratios and investigated significant fluctuations	1	2	3	4	5	1	2	3	4	5
33-34 Compared the entity's ratios with industry ratios, when available ...	1	2	3	4	5	1	2	3	4	5
35-36 Inquired concerning action taken at meetings of board of directors..	1	2	3	4	5	1	2	3	4	5
37-38 Confirmed the cash balance directly with the bank	1	2	3	4	5	1	2	3	4	5
39-40 Observed the counting of the physical inventory	1	2	3	4	5	1	2	3	4	5
41-42 Evaluated the more important accounting controls	1	2	3	4	5	1	2	3	4	5
43-44 Confirmed the accounts receivable balance directly with debtors	1	2	3	4	5	1	2	3	4	5

III. Background Information on Respondent (circle one answer per question)

45. Your age at last birthday
- Under 25 years old
 - 26-35
 - 36-45
 - 46-55
 - Over 55
46. Your highest Educational Level Achieved
- High School
 - Junior College
 - 4 years of College
 - More than 4 years of College
47. Which of the following best describes the CPA Firm with which you are employed?
- Sole Practitioner
 - Local Firm or Regional Firm (but not a Sole Practitioner)
 - National or International Firm
48. During 1983 were you involved with an engagement to compile and/or review the financial statement of a nonpublic entity (as preparer, staff member, manager in charge of the engagement, partner in charge of the engagement, etc.)
- YES
 - NO
49. What percentage of your Firm's 1983 chargeable time was associated with compilation services?
- Less than 10%
 - 10% to 25%
 - 26% to 40%
 - 41% to 55%
 - Over 55%
50. What percentage of your Firm's 1983 chargeable time was associated with review services?
- Less than 10%
 - 10% to 25%
 - 26% to 40%
 - 41% to 55%
 - Over 55%
51. What is the approximate population of the city in which your office is located?
- Less than 1000
 - Between 1,000 to 10,000
 - More than 10,000 but less than 50,000
 - Between 50,000 to 100,000
 - Over 100,000
52. How familiar are you with SSARS?
- | Not at all | | Somewhat | | Very |
|------------|---|----------|---|------|
| 1 | 2 | 3 | 4 | 5 |
- IV. Thank you for completing this questionnaire. Please return it in the self-addressed stamped envelope enclosed. If you would like to make comments, please feel free to do so on the back of this page.

APPENDIX B
BANKER QUESTIONNAIRE

MISSISSIPPI STATE UNIVERSITY • COLLEGE OF BUSINESS AND INDUSTRY
SCHOOL OF ACCOUNTANCY

Dear Mississippi Banker:

In recent years substantial changes have been made in accounting standards that govern the preparation of unaudited financial statements. Since unaudited financial statements play an important part in the credit granting process of loan officers, it is very important that the accounting profession has an awareness of bankers' perceptions of unaudited financial statements.

I am currently conducting a survey to determine the perceptions of Mississippi Bankers concerning unaudited financial statements. Your participation by filling out the enclosed questionnaire and returning it to me as soon as possible in the self-addressed stamped envelope would be greatly appreciated.

The code numbers listed on your questionnaire will be used for control purposes only. All responses will remain confidential and will be used in tabulations only; no names will be published in the research findings. I certainly appreciate your help and look forward to receiving your response.

Sincerely,

Quinton Booker

Quinton Booker, CPA
Doctoral Candidate

P.S. Please attempt to answer all questions.

- I. In recent years, The American Institute of CPAs adopted new standards to cover unaudited financial statements called Statements on Standards for Accounting and Review Services (SSARS). The standards created two new services for the nonpublic entity (A) Compilations (B) Reviews. Each of the next 12 statements refer to services offered by CPAs. Please indicate your response to each statement by circling one response per question. The following responses should be used:

(1) (2) (3) (4) (5)
Strongly Agree Mildly Agree Neutral Mildly Disagree Strongly Disagree

- | | | | | | |
|--|---|---|---|---|---|
| 1. Unaudited Financial Statements (compiled and/or reviewed) play an important part in the credit granting process in the banking community..... | 1 | 2 | 3 | 4 | 5 |
| 2. The bank with which I am employed has a policy that requires small business loan applications be accompanied by financial statements (compiled, reviewed or audited)..... | 1 | 2 | 3 | 4 | 5 |
| 3. I prefer that my small business loan customers submit Financial Statements (compiled, reviewed, or audited) when making application for a loan..... | 1 | 2 | 3 | 4 | 5 |
| 4. Financial Statements (compiled, reviewed or audited) prepared by CPAs are vital to the credit granting process at the bank with which I am employed..... | 1 | 2 | 3 | 4 | 5 |
| 5. A knowledge of the owner(s) of the business overrides the need for any type of Financial Statement in the case of most small business loans..... | 1 | 2 | 3 | 4 | 5 |
| 6. Financial statements <u>compiled</u> by the CPA provide a reasonably high degree of assurance that the statements are not false or misleading..... | 1 | 2 | 3 | 4 | 5 |
| 7. Financial statements <u>reviewed</u> by the CPA provide a reasonably high degree of assurance that the statements are not false or misleading..... | 1 | 2 | 3 | 4 | 5 |
| 8. The Division of unaudited statements into two categories by the accounting profession has led to a greater awareness on the part of the banking community of the degree of reliance to be placed on unaudited financial statements..... | 1 | 2 | 3 | 4 | 5 |
| 9. By establishing compilation services, CPAs have professionalized an activity which is not professional work..... | 1 | 2 | 3 | 4 | 5 |
| 10. The division of unaudited statements into two categories by the AICPA has confused the banking community on how much reliance can be placed on unaudited statements..... | 1 | 2 | 3 | 4 | 5 |
| 11. The banking community has a better understanding of "unaudited financial statements" since the creation of compiled and reviewed services..... | 1 | 2 | 3 | 4 | 5 |
| 12. I still regard all unaudited statements to be about equal as related to reliability and do not distinguish between compiled and reviewed statements..... | 1 | 2 | 3 | 4 | 5 |

II. Assume that an experienced CPA has been engaged to: (A) Compile financial statements in answering category A, (B) Review financial statements in answering category B. Also, assume that appropriate professional accounting standards will govern each engagement.

For each of the procedures listed below indicate your perception of the CPA's responsibility to routinely perform the procedure when engaged to: (A) Compile Financial Statements (B) Review Financial Statements. Circle one response per question in each category. The following responses should be used.

1	2	3	4	5
ALWAYS	FREQUENTLY	OCCASIONALLY	RARELY	NEVER
(the CPA has a responsibility to <u>always</u> perform this procedure in the engagement)			(the CPA <u>never</u> has a responsibility to perform this procedure in the engagement)	

PROCEDURES		CATEGORY A compilation engagement	CATEGORY B review engagement
13-14 Ascertain that the financial statements are mathematically correct.....	1 2 3 4 5	1 2 3 4 5	
15-16 Ascertain that the financial statements and the general ledger are in agreement.....	1 2 3 4 5	1 2 3 4 5	
17-18 Confirm the cash balance directly with the bank.....	1 2 3 4 5	1 2 3 4 5	
19-20 Observe the counting of the physical inventory.....	1 2 3 4 5	1 2 3 4 5	
21-22 Perform ratio analysis and investigate significant fluctuations.....	1 2 3 4 5	1 2 3 4 5	
23-24 Compare the current financial statements with prior year statements, when available.....	1 2 3 4 5	1 2 3 4 5	
25-26 Evaluate the more important internal accounting controls.....	1 2 3 4 5	1 2 3 4 5	
27-28 Confirm the accounts receivable balance directly with debtors.....	1 2 3 4 5	1 2 3 4 5	
29-30 Inquire concerning the entity's accounting principles and practices and the methods followed in applying them.....	1 2 3 4 5	1 2 3 4 5	
31-32 Inquire concerning actions taken at meetings of the board of directors..	1 2 3 4 5	1 2 3 4 5	

III. Background Information on Respondent (circle one answer per question)

33. Your age at last birthday
- Under 25 years old
 - 26-35
 - 36-45
 - 46-55
 - Over 55
34. Your highest educational level achieved
- High School
 - Junior College
 - 4 years of College
 - More than 4 years of College
35. Did you review any loan applications during 1983 accompanied by Compiled and/or Reviewed financial statements of a nonpublic entity prepared by a CPA?
- Yes
 - No
36. If your answer to question 35 is "Yes", please estimate the number of loan applications reviewed accompanied by Compiled and/or Reviewed financial statements.
- Less than 10
 - 11-20
 - 21-30
 - 31-40
 - Over 40
37. What is the approximate population of the city in which your bank is located?
- Less than 1000
 - Between 1,000 to 10,000
 - More than 10,000 but less than 50,000
 - Between 50,000 to 100,000
 - Over 100,000
38. How familiar are you with SSARS?
- | Not at all | | Somewhat | | Very |
|------------|---|----------|---|------|
| 1 | 2 | 3 | 4 | 5 |
- If your response to question 38 is "1" or "2" please answer question 39:
If your response is "3" "4" or "5" go to part IV.
39. How important is it that you are able to ascertain the responsibility taken by the CPA when financial statements (prepared by a CPA) are submitted along with a loan application.
- | Not at all important | | Somewhat important | | Very important |
|----------------------|---|--------------------|---|----------------|
| 1 | 2 | 3 | 4 | 5 |
- IV. Thank you for completing this questionnaire; please return it in the self addressed envelope enclosed. If you would like to make comments, please feel free to do so on the back of this page.

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