

NASBA

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June 25, 2009

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Re: Exposure Draft dated April 28, 2009 "Proposed Statement on Standards for Accounting and Review Services"

Dear Members of the Accounting and Review Services Committee:

We appreciate the opportunity to comment to the Accounting and Review Services Committee (ARSC) of the American Institute of Certified Public Accountants (AICPA or Institute) on the Exposure Draft (Exposure Draft) on "Proposed Statement on Standards for Accounting and Review Services" (SSARS). The National Association of State Boards of Accountancy's (NASBA) mission is to enhance the effectiveness of the licensing authorities for public accounting firms and certified public accountants in the United States and its territories. In furtherance of that objective, we offer the following comments on the proposed changes to SSARS:

Formatting, Lack of Independence in a Compilation Report and Review Evidence

We agree with the proposed arrangement of the standards into two mutually exclusive chapters, one for compilations and one for reviews. Such arrangement should facilitate practitioners' use and understanding of the standards applicable to each type of engagement.

We agree with the concept that in a compilation report where the CPA is not independent, the CPA can explain, either because of relationships or work performed, why he or she is not independent.

We also agree with the definition of "review evidence." Such a definition is needed to distinguish the use of the word "evidence" in a legal context from its use in the context of a review engagement.

Preserve the Concept of “Limited Assurance”

We do not agree, however, with altering the concept of the present review report, changing obtaining “limited assurance” that the financial statements are free of material misstatement to the new expressed concept of obtaining “moderate assurance.” In NASBA’s December 2008 response to the International Auditing and Assurance Standards Board’s (IAASB) September 2008 Consultation Paper: Matters to Consider in a Revision of International Standard on Review Engagements 2400, *Engagements to Review Financial Statements* (“Paper”) NASBA offered the following responses to their questions regarding the concept of “moderate level of assurance.”

“Q1. Is the concept of a ‘moderate level of assurance’ meaningful for practitioners?”

A “moderate level of assurance” is not a useful term for practitioners. This is clear from the range of responses concerning moderate level of assurance in the Paper. While it may be what users of financial statements seek, a “moderate level of assurance” is meaningless since it would require the practitioner to make an internal guess about the anonymous external party’s expectations. The definition of the level of assurance requires careful consideration by standard setters in a formal standard.

It is suggested that “limited assurance” be the term used as an alternative. “Limited assurance” Would then be defined as “the form of the financial statements and applicable disclosures comply with the basis of accounting presented and that based on the limited procedures performed and the knowledge of the practitioner from other interactions with the entity that the practitioner has no knowledge that the financial statements which are the representations of management (or alternatively, the engaging party) are materially misstated.” Other similar wording that conforms to what is expected of a review with limited procedures would be acceptable as well.

Stating the responsibility of practitioner as providing “limited assurance” clearly communicates the responsibility of the practitioner to users and to others since the procedures performed are less than those which would be performed in an audit. It underscores that the readers of the financial statements must recognize the limits of procedures performed when using the financial statements for their purposes – whether the purposes be investment decisions, credit decisions, or other decision making.

We do not believe the use of the word “moderate” is in the public’s interest.

Q2. How should a practitioner determine what constitutes a moderate level of assurance for a review of financial statements?

The change to “limited assurance,” suggested above, means that a determination of “moderate assurance” is not required of a practitioner. The issue then is what procedures would be needed in a review. This would require some explanation of when the inquiry and analytical procedures, and possible other specified requirements, provide a reasonable basis for meeting the definition of “limited assurance.”

Mr. Michael Glynn

June 25, 2009

Page 3 of 7

The “range of responses concerning moderate level of assurance in the Paper,” in the answer to Q1 above, referred to the results of two surveys noted in the Paper. These were conducted to ascertain practitioners’ attitudes to the level of confidence expected for audit and review engagements. The first was a 2002 survey of 52 accounting firms from around the world and the second was a 1993 survey of public accountants in Canada.

The first survey asked, “What is the percentage of confidence you believe you provide in case of a moderate level of assurance engagement and in case of a high level of assurance engagement?” The second asked participants to indicate the level of assurance provided by three types of services: audit opinions, review engagement reports and compilations.

The first survey reported that the average percentage of confidence for a high level of assurance engagement was 88 percent, and was 60 percent for a moderate level engagement. The second survey reported that the average level of assurance for an audit opinion engagement was 88 percent and was 61 percent for a review engagement.

Both surveys show that the level of confidence for moderate assurance engagements (review reports) is about 68 percent of the level of confidence for high level engagements (audit reports). Responses to a question about the assurance level of “limited” assurance engagements would likely result in a percentage significantly lower than the 60 percent assurance level reported by the surveys. Note, both surveys were of practitioners’ expectations, not the public’s.

ARSC has “determined that, in order to converge with the AT standards and ISREs and to reduce potential confusion, it would refer to the level of assurance in a SSARs review as moderate assurance.” This “conformity change” has also been presented at an AICPA Practitioners Symposium as the rationale for change.

Converting from the concept of “limited assurance” to one of “moderate assurance” is not merely a conformity change: it is a substantive change. The conformity position of ARSC is not supported by common American language. Consulting a dictionary shows that “limited” and “moderate” are not synonyms. Changing the wording alters the level of assurance. Considering that the analytical procedures and inquiries of the review engagement have not changed, the higher level of confidence that the public could rightfully assume would not be warranted.

If ARSC insists in conforming language merely “to avoid confusion,” then peer reviewers, litigators and regulators in disciplinary hearings will be able to hold CPAs and their firms to a standard of “moderate,” using the common definition of the word in the United States, rather than to a standard of “limited.” The higher standard of “moderate” will likely adversely impact CPAs and their firms.

We continue to stand behind our recommendation to the IAASB that “moderate assurance” should not be used in review reports.

ET §101-3 and ARSC

The following is an excerpt from ET Section 101, Independence, ET §101-3, as revised, of the AICPA Code of Professional Conduct.

“General Requirements for Performing Nonattest Services

1. *The member should not perform management functions or make management decisions for the attest client. However, the member may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.*
2. *The client must agree to perform the following functions in connection with the engagement to perform nonattest services:*
 - a. *Make all management decisions and perform all management functions;*
 - b. *Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee the services;*
 - c. *Evaluate the adequacy and results of the services performed; and*
 - d. *Accept responsibility for the results of the services;*

The member should be satisfied that the client will be able to meet all of these criteria and make an informed judgment on the results of the member's nonattest services. In assessing whether the designated individual possesses suitable skill, knowledge, and/or experience, the member should be satisfied that such individual understands the services to be performed sufficiently to oversee them. However, the individual is not required to possess the expertise to perform or re-perform the services.

In cases where the client is unable or unwilling to assume these responsibilities (for example, the client does not have an individual with suitable skill, knowledge, and/or experience to oversee the nonattest services provided, or is unwilling to perform such functions due to lack of time or desire), the member's provision of these services would impair independence.”

ET §101-3 contains a partial list of actions that can be taken by a CPA without impairing independence, including those referred to in the Exposure Draft as “internal control activities.” ET §101-3 requires, however, that the client meet the criteria set forth above.

After the revision of the section, there were CPAs concerned that they would not be independent because some, or possibly all, of their clients could not meet the above criteria. The only choice that such CPAs would then have would be to perform a compilation engagement and state in the compilation report that the CPAs were not independent.

Mr. Michael Glynn

June 25, 2009

Page 5 of 7

Many CPAs, however, undertook to educate their clients about misstatements, material required adjustments, proper financial statement presentation, etc. With such education, clients were able to meet the client criteria of ET §101-3 and, in fact, benefited because they became better informed about financial statements. Those CPAs were also able to educate their clients about the proper accounting for complex transactions.

There was, and is, another alternative for clients that are not able to meet the client criteria. The client can retain a CPA or other person to perform the non-attest “internal control” activities and can retain a second CPA to perform a review engagement. The objection raised to this proposition is that it would be very costly for a client. Not necessarily so. The person performing the “internal control” activities can also: prepare all of the required journal entries needed for proper financial reporting; can draft the financial statements including the footnotes; can prepare workingpapers for use by the CPA; and can even prepare the equivalent of an MD & A to explain period-to-period changes in account balances. The CPA would then only have to perform inquiry and analytic procedures and the CPA’s report. The additional cost to the client, if any, could be minimal and might depend on the client’s negotiating skills.

Some CPAs, perhaps those who complained about the effect of ET §101-3 on their ability to serve clients, were not able to educate their clients, and thus those CPAs were not able perform review engagements. Those CPAs’ complaints may have been the impetus for ARSC’s developing a path to avoid the need for compliance with ET §101-3 when reporting on review engagements.

The Exposure Draft does not present the basis for ARSC’s concluding that a CPA can express an opinion on a review report although he or she has engaged in “internal control” activities for the client. What the Exposure Draft simply states is: “. . .third party users advised that they believe that the accountant’s involvement improves the quality of the financial statements because those third party users understand that oftentimes, smaller businesses do not have the skills necessary to maintain their accounting records and prepare quality financial statements without the accountants involvement.”

The foundation for ARSC’s position is a 2003 article by four professors that “introduces an auditor reliability framework that repositions the role of the auditor independence in the accounting profession. The framework is motivated in part by the widespread confusion about independence and the auditing profession’s continuing problems with managing independence and inspiring public confidence” (A Proposed Framework Emphasizing Auditor Reliability over Auditor Independence, *Accounting Horizons*, Vol.17, No.3 September 2003: Mark H. Taylor, F. Todd DeZoort, Edward Munn and Martha Wetterhall Thomas). The authors argue “that the public interest will best be served by reprioritizing professional and ethical objectives to establish *reliability* in fact and appearance as the cornerstone of the profession rather than relationship-based *independence* in fact and appearance.”

No evidence has been provided by ARSC, or its Reliability Task Force, that in the years following publication there has been widespread discussion by academics or others of the 2003 article and its concepts. In effect, ARSC has used a lone article to support its position that a

CPA can express an opinion on a review report even if the CPA is not independent because he or she has engaged in "internal control" activities for the client. Such a position is in direct contrast to the work of generations of CPAs who crafted the independence rules and stressed the need for independence as the cornerstone of the profession and determined that independence, without exception, is required for an accountant to report on an audit or a review.

The AICPA's Professional Ethics Executive Committee (PEEC) is a senior committee of the Institute charged with the responsibilities of interpreting and enforcing the AICPA Code of Professional Conduct. Has PEEC approved the proposed positions that: (a) independence could be divided in two: independence based on relationships and independence based on requirements; and (b) that a CPA could issue a review report stating "nothing came to our (my) attention" when the CPA was not independent of the client because of the "internal control" work done for the client provided he or she was independent based on relationships? The ARSC's proposal rests on the proposition that a CPA can maintain objectivity when reporting on work that he or she prepared without the participation of a client who met the above mentioned client criteria. In effect, the CPA would have to make inquiries of himself or herself because the client would not be in a position to respond to the inquiries required by a review engagement.

Independence is the Foundation of Public Acceptance of a Review

If ARSC ultimately adopts its proposed position, grave consequences may result from its action.

The "non-independent review report" may become the standard and drive out of use the report of a CPA that is independent of his or her client. As stated in the Exposure Draft, third party users advised that they believe that the accountant's involvement improves the quality of the financial statements because those third party users understand that, oftentimes, smaller businesses do not have the skills necessary to maintain their accounting records and prepare quality financial statements without the accountant's involvement. Bankers and other third parties may demand that the CPA become involved in "internal control" activities because such involvement would result in more "reliable" statements. Were this to occur, significant additional cost would be borne by those clients that are able to meet their own accounting needs without the participation of a CPA firm or with the assistance of non-licensed accounting personnel.

Non-CPA firms might be able to make persuasive, if not compelling, arguments to State Boards of Accountancy or legislators that they should be able to issue review reports because the CPA profession has determined the concept of complete independence is unnecessary. The non-CPA firms could argue that they are as competent and objective as CPAs and that they could abide by the CPA independence rules regarding relationships. Abandonment of complete independence by ARSC may well work to the advantage of non-CPA firms.

The general public may look upon the action of ARSC as one that benefits certain CPAs but not the public. State Boards have the authority to decide that complete independence is required for review reports and through rulemaking or legislative initiative override ARSC's position and require that all review reports be prepared by CPAs who are independent under the current definition.

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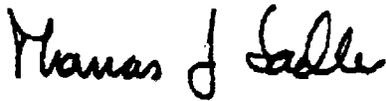
June 25, 2009

Page 7 of 7

The Exposure Draft's proposed position on independence for review engagements hits at the profession's core and, should it be adopted by ARSC, we would recommend that all State Boards of Accountancy reexamine their laws to ensure the continued protection of their public.

We hope these comments will assist the ARSC in its work.

Very truly yours,



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