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2
Brainstorming

3
Humbling Moments: Multi-year audit commitment leads to problems

5
Professional Liability Quick Quote

6
Employment Practices Liability Quick Quote

7
Save with CPA Mutual discounts

8
CPA Mutual Board of Directors' meeting highlights

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# of Mutual Interest

Compilations of forecasts – Trickier than you might think

There has been little controversy since their release in 1985 and 1986, but the "Statements on Standards for Attestation Engagements" regarding forecasts and projections, which established procedures and reporting standards for the compilation of financial forecasts, are something of a land mine for practitioners.

While minimizing potential professional liability, the standards for the compilation of a financial forecast, which were designed to permit accountants a limited form of association with the financial forecasts of a client, are becoming a litigation battleground.

Clearly, the accountant's compilation report language does not suggest that forecast-compilation engagements are a high-risk service. The very form of the compilation report is a disclaimer that discourages any reliance on the accountant's association with the forecast. But just because the profession hopes and wishes for user non-reliance, as we shall see, doesn't always make it true.

The standard compilation report reads as follows:

> "A compilation is limited to presenting in the form of a forecast information that is the representation of management and does not include evaluation of support for the assumptions underlying the forecast. We have not examined the forecast and, accordingly, do not express an opinion or any other form of assurance, on the accompanying statements or assumptions. Furthermore, there will usually be differences between the forecasted and actual results because events and circumstances frequently do not occur as expected, and those differences may be material. We have no responsibility to update this report for events and circumstances occurring after the date of this report."

Despite the strong language, other provisions of the compilation standard, as well as the AICPA *Guide for Prospective Financial*

See *Forecasts* on page 4

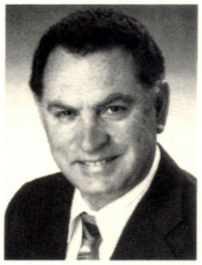
Alongi appointed to CPA Mutual Board of Directors

CPA Mutual's newest board member is no stranger to leadership, service to the profession and decision-making.

As co-founder and managing shareholder of *Pulakos & Alongi, Ltd.*, **Carl M. Alongi** has guided his firm to its position as a leading accounting and consulting group in Albuquerque, N.M. He also served as a member of CPAmerica International's Board of Directors (then known as Accounting Firms Associated, inc.), and was chairman of the board in 1995. He also held several leadership positions in the profession, including president of the New Mexico Society of CPAs and member of the AICPA Council.

"I'm extremely pleased to be part of the CPA Mutual board," Alongi says. "With current issues surrounding liability and the profession in general, it's an exciting time to be involved with the company."

Alongi's specialties in business valuation, management consulting, and organizational and strategic business planning make him popular as a speaker. In the past, he has spoken at a number of professional and civic events, including CPA Mutual and CPAmerica International conferences, seminars for the American Institute of Certified Public Accountants, functions of the Institute of Business Appraisers and various state CPA societies.


Carl M. Alongi, CPA, ABV

Alongi also serves on several CPAmerica International committees and is a business valuations

See *Alongi* on page 7

Information, plainly require the accountant to evaluate the critical elements of a compiled forecast. The provisions also obligate the accountant to make important judgments that could lead to a measure of liability despite the disclaiming report language.

According to the *Guide for Prospective Financial Information*, these judgments include whether the accountant is competent to perform the compilation procedures and whether the forecast is "not obviously inappropriate." Further, the accountant must determine whether a compilation forecast is "complete" or "misleading."

The accountant also must determine whether the client has a "reasonably objective basis" to conclude that the assumptions are "consistent with past and present conditions" and are "developed without undue optimism or pessimism." The accountant must determine whether "people knowledgeable in the entity's business and industry" would select materially similar assumptions.

Clearly, such judgments go well beyond simply reading the client's forecast and ensuring that such prospective information is presented in its proper form.

More importantly, compilation standards require that if the accountant cannot find satisfaction on these issues, he or she must withdraw from the engagement. Thus, failing to have an adequate basis for issuing even a compilation report on a forecast is not only an act of professional negligence, it also may subject the accountant to serious legal liability.

The standards for compilation engagements have other problems, as well. For example, the accountant is required to have "adequate technical training and proficiency," according to AT Section 200: *Financial Forecasts and Projections.*

What does "adequate training" and "proficiency" require? According to Appendix B of AT Section 200, the accountant "... should obtain a general knowledge of the nature of the entity's business transactions and the key factors upon which its future financial results appear to depend."

If the prospective financial statements are for a proposed entity, the accountant "should obtain knowledge of the proposed operations and the key factors upon which its future results appear to depend and that have affected the performance of entities in the same industry."

How much general knowledge of the nature of the business and the key factors that impact its financial results is the accountant required to possess? The standard is not specific, but because the accountant is required to consider whether the responsible party has a reasonably objective basis to present a forecast, he or she also must consider whether the forecast is unduly optimistic and whether the forecast is reasonably consistent with the assumptions by people "knowledgeable in the entity's business and industry."

Therefore, the accountant must have enough training and proficiency to make such informed judgments. How much knowledge is that? Apparently, however much knowledge it takes.

Ambiguity in the standards is not limited to training and proficiency. The accountant also must be familiar with the guidelines for the preparation and presentation of prospective financial statements and must ask how the responsible party identifies the key factors and develops its assumptions.

Preparation guidelines, in part, require that the assumptions be reasonable and suitably supported by such items as market surveys, general economic indicators and trends and patterns developed from the entity's operating history. Therefore, it follows that if the accountant is not assured that the major assumptions are reasonable and suitably supported, the accountant should not issue a compilation report on the forecast.

While the accountant is required to make these judgments, compilation procedures do not directly impose the duty to read or evaluate the client support material for the forecast and the related assumptions. To make these required judgments based largely on client inquiries is to invite client bias, sloppiness or outright misrepresentation. And client misrepresentations often lead to professional negligence claims.

The compilation standard requires that if the information presented in a compilation forecast is "obviously inappropriate, incomplete or otherwise misleading," the accountant should seek additional information or withdraw from the engagement. The question then becomes how an accountant is to make critical judgments about the completeness or appropriateness of information if he or she has neither read nor evaluated the information.

Any question about a material assumption triggers an obligation to read and evaluate the client support material and may further create a duty to obtain additional confirming information or a withdrawal from the engagement.

Guidance for what defines a reasonably objective basis is equally ambiguous:

> "The responsible party has a reasonably objective basis to present a financial forecast if sufficiently objective assumptions can be developed for each key factor." – *AICPA Guide for Prospective Financial Information*

Among the matters to be considered are whether facts can be obtained and informed judgments made about past and future events or circumstances in support of the underlying assumptions.

Simple enough in theory, but to what level must one go in practice, particularly if one is not required to read or evaluate the responsible party's support of its assumptions?

Like much in this standard, the issue is not clear. Such ambiguity raises the question of whether association with forecast compilations is worth the risk that performing such services ultimately may bring.

By Gordon Yale, CPA, CFE
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