

**A GUIDED TOUR OF ENGAGEMENT LETTERS  
AND “WHAT WE DO”**



**A GUIDED TOUR OF ENGAGEMENT LETTERS  
AND “WHAT WE DO”**

**CPA MUTUAL INSURANCE COMPANY OF AMERICA  
RISK RETENTION GROUP**

4923 NW 43<sup>rd</sup> St Ste C, Gainesville, FL 32606  
Phone: (352)-240-7800 or 1-800-543-3029

[www.cpamutual.com](http://www.cpamutual.com)

Copyright 2018, CPA Mutual Insurance Company of America RRG, All rights reserved.  
No portion of this work may be reproduced or used for any purpose  
whatsoever without the advance written consent of the owner,  
CPA Mutual Insurance Company of America RRG.

## TABLE OF CONTENTS

I.	Introduction.....	1
II.	A Guided Tour of the “What We Do” Publication .....	1
III.	Key Engagement Letter Features .....	3
	Appendix A - “What We Do” .....	11
	Appendix B - Form Engagement Letters for Audit, Review and Compilation Agreements.....	20
	Appendix C - Form Tax Return Preparation Engagement Letter.....	37
	Appendix D - Form Engagement Letter for Litigation Services .....	41
	Appendix E - Form Engagement Letter for Obtaining Financing .....	44
	Appendix F - Form Financial Statement Engagement Letter (SSARS 21).....	48
	Appendix G - Form Nonattest Service Engagement Letter for Attest Client.....	53
	Appendix H - Form Bookkeeping with restricted use Clause.....	57
	Appendix I - Form Reply Letters For Use after Receiving Notice of Intended Third Party Use of Audit, Review or Compilation Report .....	61
	Appendix J - Sample Limited Liability and Indemnification Language for Use in Engagement Letters .....	73
	Appendix K - Sample Individual 1040 Engagement Letter .....	75

## **INTRODUCTION**

Remember “The Expectations Gap”? This phrase has been used widely to discuss the difference between what accountants do, and what their clients may think they do. Some, including elected officials and organizations representing the accounting profession, have taken the position that The Expectations Gap should be narrowed by having accountants take responsibility for doing more of what their clients think they should do. There is another way to narrow The Expectations Gap. Accountants can do a better job of educating their clients about what they do – and don’t do.

The “What We Do” publication provides, in layman’s language, an explanation of:

- (1) what accountants do in connection with financial statements, the preparation of income tax returns, and consulting services; and
- (2) what is expected of individual clients and/or management in connection with these accounting services.

The “What We Do” publication is intended to not only inform clients, but also judges and jurors who may later be called upon to adjudicate a client’s or user’s professional liability claim. It may serve to protect the accountant from undue liability exposure, as well as to educate the client as to the limits of accountants’ services, so that the client can make an informed decision as to the level of service to be performed.

What follows is a guided tour of the “What We Do” publication and key engagement letter features. We have also attached as appendices the “What We Do” publication along with form letters illustrating key engagement letter features. CPA Mutual’s insureds should use **both** an engagement letter and the “What We Do” publication.

## **II.**

### **A GUIDED TOUR OF THE “WHAT WE DO” PUBLICATION**

The following summarizes the subjects covered in the “What We Do” publication, which is attached hereto as Appendix A.

#### **A. Audits, Reviews and Compilations**

*Management’s Responsibilities In Connection With Financial Statements*  
Management is responsible for having a system of procedures and controls which enable the production of financial statements, for maintaining its system and controls, and for being honest with the accountant. The objective is to have financial statements which are not materially misstated, rather than “correct” since many items are estimates.

The financial statements are management’s, **not** the accountant’s, even though the accountant may process transactions reported by management, or print the financial statements from his (the accountant’s) computer. Management is, therefore, responsible for the company’s financial statements.

*Fundamental Differences in Audit, Review, and And Compilation Engagements* This section explains the accountant’s different roles in compilation, review and audit engagements.

While accountants are supposed to “sniff around” in all three types of engagements, the accountant performing a compilation is not required to perform any procedures unless he smells something funny. An accountant performing a review is supposed to inquire and perform analysis, and may perform some verification procedures if his inquiries, analysis, or sniffing around leads him to wonder about something. An accountant performing an audit is expected not only to sniff, inquire, and analyze, but also to test. The auditor is expected to test samples and obtain evidence so that he may express an informed opinion.

***Fundamental Differences Between Audit, Review, And Compilation Reports*** This section explains that a compilation report offers no assurance as to the fairness of the financial statements, while the review offers limited assurance, and the audit offers reasonable assurance. None of the three reports attempts to offer complete or absolute assurance that the financial statements are fairly presented.

***Audit Engagements*** Here we explain what accountants do during an audit engagement, with particular emphasis on selective testing. A financial statement audit differs from an IRS audit, both in scope and the auditor’s attitude concerning the subject of the audit. The concept of materiality is also explained. Finally, this section discusses the risks of not detecting an irregularity or illegal act.

***Review Engagements*** The limited nature of a review is the focus of this portion of the publication. Key phrases from the review report are examined, emphasizing both the limited nature of the services performed, and the negative assurance provided by the review report (*i.e.*, that the accountant is not aware of needed material modifications). Examples are provided of typical review inquiries and analytical procedures.

***Compilation Engagements*** The very limited nature of a compilation engagement is discussed. Examples are given of the types of issues that might cause an accountant to ask questions during a compilation engagement.

## **B. Preparation of Income Tax Returns**

***What An Accountant Does When Preparing An Income Tax Return*** Most clients understand in general terms their obligation to file annual federal, state and/or local income tax returns. However, many clients do not understand what an accountant does and does not do as the “preparer” of their returns. This section discusses what an accountant does when preparing income tax returns, including the accountant’s function to evaluate and recommend tax positions, and complete necessary tax forms.

***What An Accountant Does Not Do In Preparing An Income Tax Return*** Here we explain what an accountant does not do in preparing a client’s income tax return. The accountant does not audit, examine, or verify information provided by the client. The accountant does not retain documents or other data necessary to prove any claimed income, deductions or credits. The accountant may also have no obligation to communicate with the client when subsequent events occur that change previously provided advice.

***The Taxpayer’s Responsibilities In Connection With Income Tax Returns*** This section discusses three fundamental client responsibilities in connection with an accountant’s tax return preparation. First, we explain the client’s responsibility to properly record their transactions, safeguard assets, and/or for the substantial accuracy of their financial records. Second, we discuss the client’s responsibility to provide accurate, complete and timely information. Finally, we discuss the client’s ultimate responsibility for all representations in the final return, and their responsibility to retain documentation proving the accuracy of those representations (*i.e.*, proof evidencing the validity of income and/or deductions).

### C. Consulting Services

An accountant provides consulting services in many different ways. Here we explain four types of consulting services accountants frequently perform: consultations, advisory services, implementation services and transaction services. We also discuss the accountant's function in each of these engagements, as well as the types of analytical processes the accountant may use in the consulting process.

## III.

### KEY ENGAGEMENT LETTER FEATURES

#### A. The Audit Engagement Letter

Key features of an audit engagement letter include the following:

***Scope Of Work*** This paragraph defines the work to be done, and identifies the client. Be sure to use the correct legal name of the client.

***Management Responsibilities*** This paragraph describes the role of management, and explains why the financial statements are management's representations, even if the accountant prepares them. It also explains management's responsibility to provide an internal control structure designed to yield reliable financial statements, as well as management's responsibility to make all financial records and related information available to the auditor in a timely fashion.

***Character And Limitations Of An Audit*** This paragraph explains the limitations of an audit, including selective testing and the concept of materiality. It explains that Generally Accepted Auditing Standards (GAAS) requires that audits be designed to detect material errors, irregularities and illegal acts, and explains why such acts may not be detected. This paragraph calls for the client to be totally honest with the auditor, but explains that the auditor neither assumes client dishonesty or unquestioned client honesty. This portion of the engagement letter describes the judgments that auditors make, and the room for differences in professional judgment. Finally, this portion of the engagement letter explains the management representation letter, and the difference between an unqualified and a qualified audit opinion.

***Third Party Use And Reliance*** This portion of the engagement letter calls upon the client to identify known users of the audit engagement letter. If the only intended user of the audit report will be the corporate client, then the engagement letter should state as such. If other parties (*i.e.*, other entities, shareholders, etc.) also intend to use or rely on the audit report, then the engagement letter should specifically identify these third parties as well. Some might question whether it is advisable to inquire as to third party users. However, you may find that you are better able to plan your audit, and to fairly price your work in connection with the known risks, if you are given an accurate understanding of the users who may wish to rely upon your audit report.

The engagement letter also references the "What We Do" publication. Every known user of the audit report should be given a copy of the engagement letter and the "What We Do" publication. This will assure that every known user has been given an opportunity to learn, in plain English, about the different roles and responsibilities of management and its outside auditor.

Circumstances may arise during an accountant's audit, review or compilation planning, or after a report is issued, which give the accountant notice that new or additional third parties intend to rely on the accountant's report. An accountant should not let notice of the new third party use go unaddressed, even if it is believed that the engagement letter addresses unauthorized third party use. A response is warranted to avoid any appearance that the accountant is acquiescing to the third party use. In Appendix G we provide sample response letters, which illustrate examples of how to respond when the accountant learns that the client intends to provide the accountant's audit, review and/or compilation report to a previously undisclosed third party.

***Termination of Engagement*** Each engagement letter should explain that circumstances may arise which prevent completion of the engagement or may require the accountant to withdraw from the engagement. This section should also define when the accountant and/or client may terminate or withdraw from the engagement. We recommend using broad language allowing both the client and accountant to terminate the engagement at any time and for any reason, subject to any rules of professional conduct that may apply to the accountant. Should you decide to use a more narrow provision, this paragraph should at a minimum state with particularity the circumstances under which withdrawal or termination is permitted. These circumstances may include the client's failure to cooperate, provide timely information, or pay fees when due, among others.

***Indemnification And Limited Liability Provisions*** The permissible scope of indemnification and limited liability clauses depends on the nature of the engagement, as well as the federal, state and/or local laws that apply.<sup>1</sup> Further, because of the accountant's obligation to remain independent in an attest service engagement, the accountant must exercise caution to avoid using limited liability or indemnification provisions which may impair independence.

For example, certain regulated industries, such as public companies regulated by the Securities and Exchange Commission, or financial institutions regulated by the Office of the Comptroller of the Currency (among others), have issued rules which prohibit or seriously limit the use of certain limited liability and indemnification agreements in audit or other attest service engagements. The American Institute of Certified Public Accountants' ("AICPA") current position on the use of limited liability and indemnification provisions in attest service engagements is in flux, and may therefore change in the near future. However, there is no prohibition against spelling out client responsibilities in a way that might allow the accountant to later hold the client accountable for breaking its promises.

Accordingly, each engagement letter should document the client's promise to make full and truthful disclosure of all pertinent facts, and make every diligent effort to maintain proper books and records that reflect its business activities. It should also document the client's promise to immediately advise the accountant if it becomes aware of any inaccuracy in its record-keeping or dishonesty in any of its business dealings.

Where permissible, an express limited liability and/or indemnification provision may also be appropriate. As a general proposition, broader limited liability and indemnification language will be permitted in nonattest engagements because an accountant's independence is not a concern. **Any limited liability and indemnification language used in the attached form engagement letters should be tailored to meet all legal, industry and ethical requirements governing both the client and the accountant.**

---

<sup>1</sup> Specific state law, rules and regulations may invalidate certain types of indemnification and limited liability provisions. Neither this publication, nor the accompanying appendices attached hereto consider these state specific laws. Therefore, before deciding which indemnification or limited liability provision to use for your particular engagement, we recommend that you contact us.

In Appendix H, we provide sample limited liability and indemnification language to consider when drafting your engagement letter. This language may not be appropriate for all engagements for the reasons discussed above. We recommend that you consult with legal counsel in advance to determine which type of limited liability and indemnification language is appropriate for your particular engagement.

***Dispute Resolution*** A dispute resolution clause allows the parties to elect how a dispute will be resolved before the dispute actually arises. Alternative dispute resolution (“ADR”) procedures, such as negotiation, mediation and arbitration, may be helpful in timely resolving client disputes and reducing litigation costs.

Negotiation and mediation may further a mutually agreeable resolution to a dispute. Binding arbitration on the other hand is an alternative method for having a dispute finally decided outside the formal court room setting.

Arbitration clauses in engagement letters should generally require:

- The appointment of a mutually agreeable arbitrator;
- That the arbitration proceeding be governed by the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants;
- That the arbitrator’s award be final and binding; and
- That the judgment on the award may be entered in any court having proper jurisdiction.

Leaving flexibility for choosing the presiding arbitrator can be important if a dispute arises. For example, some disputes may involve complex accounting issues or professional standard disputes. Appointing a local arbitrator who is a licensed CPA may be best suited to make an informed decision about whether a material deviation from professional standards is a direct cause of any alleged damages. On the other hand, your defense may focus more on technical legal issues, for which you would rather have decided by an attorney with experience in those legal issues.

ADR provisions, however, also may not be appropriate for all engagements or enforceable in all jurisdictions. We recommend you consult with legal counsel to determine which ADR mechanism, if any, is appropriate for your engagement.

### ***Confidentiality and Third Party Requests for Information***

An auditor’s work papers and audit documentation are the property of the auditor. You may consider explaining this to the client within the engagement letter to avoid future conflict. Further, while an accountant may not generally disclose confidential client information, there are exceptions to this rule recognized by the profession and some state or local laws. For example, an accountant may be required to respond to a subpoena, court order or other legal process. The accountant may also be required to give testimony in Court or at a deposition. This may require a substantial investment of time by the accountant. Accordingly, each engagement letter should require the client to compensate the accountant for responding to production requests or giving testimony, and reimburse the accountant for any expenses associated with responding to such requests, including any attorneys’ fees expended.



## ***Billing***

Each engagement letter should establish an understanding with the client concerning the accountant's billing practices. This paragraph will likely vary between each firm. However, you should consider identifying how fees will be calculated (i.e., hourly rate), the range of hourly rates within the firm, and the specific rates of accountants of different experience levels who you anticipate will work on the matter. You should also consider identifying the firm's practice for sending invoices in connection with each engagement.

## ***Integration and Modification***

Each engagement letter should include an integration and modification clause. An integration clause is a provision which establishes that the written engagement letter sets forth the entire agreement between the client and accountant. The purpose of this provision is to prevent any later claim that the client and accountant expressed other oral or written promises or representations which were not incorporated into the engagement letter or modified the parties' obligations. A modification clause serves to limit the circumstances (i.e., written consent of both parties) under which the terms of an engagement may be modified.

## **B. The Review Engagement Letter**

The review engagement letter follows the same format as the audit engagement letter but contains language unique to the review engagement as required by SSARS 19. This includes:

**Objectives of a review:** Provide limited assurance that no material modifications are needed.

***Character And Limitations Of A Review*** This portion of the engagement letter explains the inquiry and analysis procedures involved in a review. It distinguishes a review from an audit in several key respects: a review does not include obtaining an understanding of the entity's an system of internal control; assessing fraud risk; testing accounting records and obtaining evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit. It also explains that a review engagement does not result in the expression of an opinion. It explains that a review report expresses limited negative assurance to the effect that the accountant is not aware of any material modification required to make the financial statements in accordance with generally accepted accounting principles and is substantially less in scope than an audit.

**Management responsibilities:** Include the preparation and fair presentation of financial statements; prevention and detection of fraud; design, implement and maintenance of internal controls; compliance with laws and regulations, make available all financial records, and provide accountant with representation letter.

## **C. The Compilation Engagement Letter**

The compilation engagement letter follows the format of the review engagement letter, but differs in substance, with the following principal exceptions:

***Character And Limitations Of A Compilation Engagement:*** The compilation engagement letter explains the differences between an audit, review and compilation engagement, and invites the client to determine whether a compilation engagement meets its needs. The compilation engagement letter explains that the accountant will neither review, nor audit management's financial numbers or make any assessment of internal control. The

compilation engagement letter also clarifies that it will provide no assurances as to the financial statements and no assurance as to the detection of errors, fraud, irregularities or illegal acts.

The compilation engagement letter identifies the objective of the compilation; i.e., to assist management in presenting financial information in the form of financial statements. In performing a compilation, the accountant uses information that is provided by management, without undertaking to obtain or provide any assurance as to whether material modifications should be made in order for the financial statements to conform with applicable financial reporting standards.

In a compilation engagement, management is responsible for the preparation and clear presentation of financial statements in accordance with the applicable financial reporting standards, for designing, implementing and maintaining internal controls to aid in the preparation and fair presentation of the financial statements, to prevent and detect fraud, for identifying and ensuring that the business complies with applicable laws and regulations, and for making all financial records and related information available to the accountant.

Like a review or an audit, a compilation does not involve the accountant performing inquiry, analytical procedures, or other procedures typical of a review engagement. Neither does a compilation contemplate obtaining an understanding of the entity's internal control; assessing fraud risk; testing accounting records by obtaining sufficient audit evidence through inspection, observation, confirmation, or the examination of source documents; or other procedures ordinarily performed in an audit.

The compilation engagement letter should also state whether the accountant expects to issue a compilation report that expresses any impairment of the accountant's independence.

#### **D. Tax Return Preparation**

Key provisions of a tax return preparation engagement letter include the following:

***Introductory Paragraph*** This paragraph identifies the purpose of the engagement letter, i.e., to confirm the engagement, confirm the individual responsible for tax matters, clarify the nature and extent of the accountant's services, and identify the mutual responsibilities of the parties.

***Character And Limitations Of Services To Be Provided*** This section identifies what federal, state and/or local income tax returns the accountant intends to prepare on the client's behalf. This section also discusses the accountant's exercise of professional judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law.

Here the engagement letter also identifies and discusses the limitations of the engagement. The engagement letter explains that the accountant's preparation of income tax returns is not designed to discover the misuse of funds or other irregularities. It also explains the client's responsibility to properly record transactions and for the final tax return itself.

***Termination of Engagement*** This paragraph defines the circumstances under which the client and accountant may terminate or withdraw from the engagement.

***Limited Liability And Indemnification*** As indicated above, the permissible scope of limited liability and indemnification clauses in nonattest service engagements, such as the preparation of income tax returns, is generally much broader than in attest service engagements

where the accountant must maintain independence. Therefore, in most circumstances, it is appropriate to include broader limited liability and indemnification language in an engagement letter for the preparation of income tax returns than used in an audit or review engagement. However, at a minimum the engagement letter should spell out the client's responsibilities in a way that will allow the accountant to later hold the client accountable for breaking those promises.

**Dispute Resolution** Similar to the audit, review and compilation engagement letters it may also be appropriate to include a dispute resolution provision. We recommend you consult with legal counsel in your state to confirm such a provision is appropriate in your jurisdiction.

**Billing, Confidentiality, Third Party Requests for Information and Integration/Modification** Similar to the audit, review and compilation engagement letters above, the tax return preparation engagement letter should also address the issues of billing, confidentiality, third-party requests for information and integration/modification.

#### **E. Consulting Services**

Consulting engagements may vary widely in the type of services provided, as well as the client's objectives. Consulting service engagement letters, therefore, need flexibility in content and format. The following are some provisions which an accountant should consider when drafting a consulting engagement letter:

**Background** This first paragraph briefly restates the client's history, any previous conversations with the client, and the client's perception of the problem in the client's own words.

**Objectives** The accountant's role in a consulting service engagement is to serve the client's interest by seeking to accomplish certain defined objectives, while maintaining integrity and objectivity. The engagement letter should define the client's objectives and ensure that the client and accountant have a clear understanding of those objectives from the outset.

**Nature and Scope of Engagement** This paragraph defines what the accountant intends to do in furtherance of the client's objectives, and the order he or she intends to undertake those tasks. The substance of this paragraph will depend on the nature of the engagement. For example, the accountant may be retained to prepare documents for the purpose of obtaining financing for the client's business operations. This may require the accountant to determine the amount of financing needed, the purpose for the financing, and the sources and methods for obtaining the necessary financing. A business plan and other documents may also need to be prepared for the client to make an effective presentation of the need for financing to a financial institution.

**Roles** In a consulting engagement, the accountant must establish an understanding with the client about the responsibilities of the respective parties. Therefore, it may be appropriate in certain consulting engagements for the engagement letter to more definitely define the accountant's and client's role in the engagement.

Some consulting service engagements may require the client to produce business records, make staff available for interviewing or make timely decisions on various aspects of the engagement. These client roles, and any other client responsibilities should be clearly identified.

Similarly, the accountant's role should be defined. The accountant's responsibilities will vary based upon the nature and scope of the engagement, but may include things such as gathering data about the history and finances of the client's business, analyzing records, or

preparing documents. The accountant's role, and any others that may apply to the specific engagement, should also be clearly stated.

**Results And Benefits** The accountant should set forth any tangible end product that is contemplated by the parties. This again will depend on the nature of the engagement. In many cases, the tangible work product will be some written report of findings, conclusions and/or recommendations. However, it may be in some other form, such as the preparation of identified financing documents or a business plan.

The accountant should also identify any intangible benefit that the client may recognize from the engagement. This may include, among other things, a better understanding of management's goals, business opportunities, or challenges facing the business.

**Limitations Of Engagement** Limitations on an accountant's role as a consultant may vary depending on the nature of the services the accountant is retained to provide. In identifying the limitations to the engagement, an accountant should consider what things his work will not encompass. For example, it may be necessary to document the parties' understanding that the accountant will not participate in the implementation of recommendations. It may also be necessary to document that the accountant's work is not designed to identify or detect any errors or irregularities in the client's financial statements. Whatever the limitations of the engagement are, they should be clearly documented and understood by the parties.

**Project Staffing And Scheduling** Consulting engagements may require the involvement of the client's staff, in addition to the accountant (or accountant's firm). This paragraph should indicate the accountant or members of the accountant's firm who may work on the particular project, as well as any involvement of the client's staff that may be necessary. This paragraph should also set forth any time limitations on the project or phases of the project. To the extent the completion of the accountant's work may depend on a third party's timely performance, contingencies should be made in this paragraph for any third party delay that may result.

**Engagement Completion And Termination** The completion of consulting work is not always easily defined. Therefore, it may be appropriate to identify with particularity in the engagement letter the anticipated event that will mark the completion of the accountant's work. Additionally, this paragraph should define the circumstances under which the client and accountant may terminate or withdraw from the engagement.

**Third Party Use and Reliance** Where a third party may use or rely on an accountant's work, the accountant should consider addressing such use at the outset. The accountant should consider identifying any third parties who may use or rely on the accountant's work product, and document the client and accountant's understanding of the limitations on any third party use. The accountant should also consider requiring the client to obtain written consent from the accountant before any additional third party may use the accountant's work product, as well as distribute the "What We Do" publication to all third parties who intend to use or rely on their work.

**Limited Liability and Indemnification** As discussed above, the permissible scope of limited liability and indemnification clauses in nonattest service engagements is generally much broader than in attest service engagements where the accountant must maintain independence. The consulting service engagement letter should, therefore, include broader limited liability and indemnification provisions than will typically be used in an audit or review engagement.

**Dispute Resolution** This paragraph can generally follow the format discussed in the Audit Engagement Letter section above. However, we recommend consulting with legal counsel to determine which, if any, ADR mechanisms are appropriate for the particular consulting engagement involved.

**Billing, Confidentiality, Third Party Requests for Information and Integration/Modification** It may also be appropriate to address issues relating to billing, confidentiality, third-party requests for information and integration/modification (discussed above) when entering an engagement for consulting services.

#### **F. The Nonattest Service Engagement Letter For Attest Clients**

When an accountant performs nonattest services for an attest client, the accountant is prohibited from performing management functions or making management decisions. The AICPA Code of Professional Conduct requires that an accountant establish and document in writing his or her understanding of the engagement with the client, including the services to be performed, the objectives of the engagement, the responsibilities of the parties, and any limitations on the engagement. The client also must acknowledge acceptance of certain responsibilities. Therefore, in addition to the third party liability, limited liability and dispute resolution provisions described above, an engagement letter involving nonattest services for an attest client should include the following provisions:

**Services To Be Performed** This paragraph defines the services that the accountant agrees to perform. The nature and scope of the services should be mutually defined by the client and accountant in advance and clearly documented in the engagement letter.

**Objectives Of The Engagement** Here the objective(s) of the engagement should be defined. The objectives will depend on the purpose of the engagement and the client's goals.

**Accountant's Responsibilities** The accountant's responsibilities will also depend, in part, on the nature of the nonattest engagement. However, the engagement letter should explain the accountant's responsibility to remain independent in light of the attest services he or she is also providing to the client.

**Client's Acceptance Of Responsibilities.** The AICPA Code of Professional Conduct requires that the client must agree to perform the following functions in connection with the accountant's 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;
- (d) Accept responsibility for the results of the services; and
- (e) Establish and maintain internal controls, including monitoring ongoing activities.

**Limitations of Engagement** In addition to any limitations that are specific to the individual engagements, this section should explain that the accountant cannot and will not perform any management functions or make any management decisions in connection with his or her nonattest services, but may provide advice, research materials, and recommendations to assist the client's management in performing its functions and making decisions.

## APPENDIX A

### “What We Do”

A surprising number of individuals and business owners do not understand what their accountant does. As a result, many people find that the services they engage their accountant to perform are not the services they expected to receive. In short, there is an “expectations gap.”

This publication is intended to narrow the expectations gap by explaining some of the key services an accountant provides (and does not provide) in connection with financial statements, income tax returns, and consulting engagements. It is our hope that this publication informs you about what accountants do, and assists you in deciding what service is “right” for you. If you have any questions, give your accountant a call.

Whenever CPA is used in this publication, it means a sole practitioner CPA, or firm of CPAs, whose name is used to sign a report or tax return. CPA is designated an “auditing CPA” for auditing engagements, a “reviewing CPA” for review engagements, a “compiling CPA” for compilation engagements, and a “preparing CPA” for tax return preparation engagements.

#### **A. Audits, Reviews, And Compilations**

##### ***Management’s Responsibilities In Connection With Financial Statements***

Management is responsible for having a system of procedures and controls (safeguards and crosschecks), to enable the production of financial statements that are not materially misstated. The term “not materially misstated” is used rather than the term “correct” since many of the items in financial statements are estimates, and, accordingly, there are no accounting or auditing services offered to provide assurance that financial statements are “correct” or “exact.”

Management is responsible for processing transactions and advocating a proper respect for its recordkeeping system, as well as enforcing a proper regard for recordkeeping and controls designed to keep recordkeeping reliable. Management assumes the responsibility for being totally open and honest with the CPA and for advocating such openness and honesty. This openness and honesty specifically includes knowledge of the possibility of the existence of errors (unintentional misstatements or omissions of amounts or disclosures), irregularities (intentional ones) and illegal acts (violations of laws or government regulations [including but not limited to embezzlement and fraud] made by or on behalf of the entity). Management is responsible for adjusting the company’s financial statements to correct material misstatements and for affirming to the accountant in a representation letter that the effects of any uncorrected misstatements are immaterial to the financial statements taken as a whole.

The financial statements produced are management’s, not the CPA’s, because the transactions on which the financial statements are based are management’s, not the CPA’s. The CPA doesn’t deposit the receipts, write the checks, make the sales or incur the expenses. Management does these things. Management owns the assets and incurs the liabilities. Management is supposed to keep records of its business activity. The CPA doesn’t.

Though a coach may help an athlete train, critique and influence the athlete’s techniques, and express an opinion of the athlete’s abilities, the athlete’s performance is his, not the coach’s. Similarly, management’s financial statements are management’s statements, not the accountant’s, even though the accountant may question or advise management, or express an opinion on management’s statements. Management is, therefore, responsible for identifying and

ensuring that the company complies with the laws and regulations applicable to the activities, and for making all financial records and related information available to the accountant.

The CPA may process the transactions and/or produce the financial statements on his computer or cause adjustments, sometimes substantial, to be made so that the financial statements are not materially misstated. However, since the financial statements are based on management's transactions, they are still management's financial statements, not the CPA's.

This fundamental fact is emphasized in CPAs' reports. For example, the first paragraph of the auditors' standard report states: "These statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit." The first paragraph of the reviewers' standard report states: "All information included in these financial statements is the representation of the management." The second paragraph of the compilers' standard report states: "A compilation is limited to presenting in the form of financial statements information that is the representation of management."

When management includes an individual component (*e.g.*, inventories) in its statement of financial position, inherently it is making several assertions (positive statements or declarations) about the component. It is saying that the component is real (it exists), it is saying that it is priced right (it is valued properly according to the accounting rules), it is theirs (there are no liabilities except those disclosed), it is complete (there isn't any more or less), and that the words used to describe it are enough to meet the disclosure rules. For another example, when management includes sales at a certain figure in its operations statement, it is saying that sales actually occurred in that amount and that there were no other sales for the period.

### ***Fundamental Differences In Audit, Review, And Compilation Engagements***

In all three types of engagements, the CPA is supposed to sniff for anything that smells peculiar. As a matter of fact, in all his work the CPA is supposed to sniff. Sniffing is not a procedure. It is a pervasive requirement and attitude. It is called professional skepticism. It means an accountant should keep his wits about him.

In a compilation engagement, the compiling CPA is supposed to sniff. But he is not required to perform any procedures unless he smells something "fishy," or worse, in a financial statement. In that case he is supposed to look into what smells and get some more information or, as the need may be, cause management to make or agree to corrections. Otherwise, he is not required to go beyond keeping his wits about him as he uses management's numbers from its records and puts those numbers into familiar financial statement formats.

In a review engagement, the CPA goes beyond this and is required to perform so-called inquiries and analytical procedures, *i.e.*, he is supposed to ask some questions and compare this year's numbers in the financial statements with other numbers. If the answers to his questions, or the comparison of the numbers, cause him to wonder about some of the figures in the financial statements, he is supposed to follow through with other procedures and, if need be, cause management to make or agree to corrections. Following through may consist only of asking some more questions. On the other hand, if he doesn't get good answers, it may cause him to perform some verification procedures. But these additional procedures are performed only in connection with the figures he is wondering about. Otherwise he is only required to ask questions and compare numbers. At the conclusion of a review engagement the accountant issues a review report, stating that the accountant is unaware of any material modifications required in the financial statements. This is "negative assurance," and is not an expression of an opinion on the financial statements.

In an audit engagement, the CPA also sniffs around, as would be the case in a compilation, and asks questions and compares numbers, as would be done in a review. But, in addition, an auditor has to feel, touch and taste, so to speak. He has to examine the evidence; he has to get the facts. But, for the greatest part, he will examine a portion of the evidence, a sample of it, sometimes a very small sample. He must do some testing. For examples: usually he reconciles (tests the reconciliations of) some bank accounts; he asks some customers to verify their balances; he observes and test-counts some inventory items; he searches for some unrecorded liabilities; he examines and compares with the accounting records, some sales invoices, some purchase invoices and some expense invoices. When he performs these types of auditing procedures, sometimes he may be required to dig deeper, depending on his findings.

### ***Fundamental Differences Between Audit, Review, And Compilation Reports***

Upon completion of his engagement, the CPA renders his report. This report broadly states what he has done and the conclusions he has reached. In an auditors' standard report, the auditing CPA expresses his opinion and that opinion provides ***reasonable assurance*** about whether the financial statements are free of material misstatement. The auditing CPA expresses ***reasonable assurance*** because he cannot express absolute assurance since he has only examined a portion of the evidence, sometimes a very small portion.

In a reviewers' standard report, the reviewing CPA only expresses ***limited assurance*** that insofar as he is aware, the statements do not require any material modifications. The assurance is limited because the procedures are so limited.

In a compilers' standard report, the compiling CPA expresses ***no assurance*** because he has performed no procedures upon which any assurance can be based.

None of these reports offers ***complete or absolute assurance*** that the financial statements are fairly presented. Such a complete or absolute assurance is beyond the scope of an accountant's work.

### ***Audit Engagements***

The second paragraph of the auditors' standard report states:

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

The key phrases are "reasonable assurance," "material misstatement," "test basis," and "reasonable basis."

Auditing is a testing-samples-of-items business. That's the way it must be because no one can afford a 100% comprehensive audit in which every transaction and every item of business would be audited. An audit of financial statements is entirely different from an audit by the IRS which may make the taxpayer prove with documentation every single item in a tax return. Also, unlike the IRS, which may assume at the outset that the taxpayer's return is incorrect, the auditing CPA does not assume that management's financial statements are incorrect.



Using generally accepted auditing procedures, the auditing CPA selects a sample, sometimes a very small sample, of the population, and tests that sample. If the sample is supported by the evidence, then he can conclude that the entire population is supported by similar evidence. It's like sampling to predict the outcome of an election. Sometimes even a few minutes after an election, the outcome is known based on the returns of a minute portion (a sample) of the voters. That sample of voters is attributed to the entire population of voters.

In a test basis audit, the auditing CPA evaluates the effectiveness of certain matters (so-called risk assessments) and their consequent effect on the degree of his testing. Does management tend to override its own controls? Is the Company's performance erratic? How stable is the industry? How inherently risky is an item (inventories vs. property)? How good are the system and controls?

There's a pretty long list of matters to be evaluated and there is substantial guidance in the profession's Statements on Auditing Standards. Generally speaking, the greater the tendency of management to override, the more testing required. The better the system and controls, the less testing required.

Each auditor exercises his own judgment as to risk assessment. An auditing CPA's evaluations may differ from other CPAs' evaluations and still be within an acceptable range. Assuming all these risk assessments turn out to be low-risk, then the auditor's testing will be at the low end. But the auditor can still only provide "reasonable assurance" because the audit is still based on tests of samples. Furthermore, for virtually the same reason, he can only provide reasonable assurance that the financial statements are free of "material" misstatements.

The auditor's testing of inventories may show an inventory of \$97,000 whereas the Company's financial statements show \$100,000. He may conclude "that's close enough"; *i.e.*, that's not a material misstatement. The same kind of conclusion may be reached with something like depreciation, which is always an estimate so CPAs' evaluations may differ and both of them can still be right.

Further, a misstatement may be material standing alone but not material in relation to the financial statements taken as a whole. For example, a \$15,000 misstatement in a \$100,000 inventory is material in relation to the inventory but is not material in relation to a \$1,000,000 stockholders' equity in the same statement. An undiscovered \$25,000 embezzlement may sound like a material irregularity but may be immaterial in relation to both cash balance and stockholders' equity.

The concept of reasonable assurance applies not only to errors but also to irregularities and illegal acts. Errors are unintentional mistakes whereas irregularities are intentional ones. An audit is designed to provide reasonable assurance of detecting material irregularities. However, because of the characteristics of irregularities, particularly those involving forgery and collusion, a properly designed and executed audit may not detect a material irregularity. An audit is also not designed to detect errors or fraud that is immaterial to the financial statements.

Here are some examples of irregularities that may well not be detected by an auditing CPA. Forged signatures (or the unauthorized use of a signature stamp) of key officials like check signers, credit approvers, or purchase order approvers. Collusion between a cashier and an accounts receivable clerk. Collusion among several individuals involved in ordering and maintaining inventory records and handling inventories. Theft of items from inventory, or cash from a cash drawer.

These types of irregularities may never be detected or may not be caught until some time after an engagement has been completed. That does not necessarily mean that the CPA performed inadequate audit procedures. Similarly, a material error may not be caught until after the engagement. That also does not necessarily mean the CPA did not follow generally accepted auditing standards.

A company may separately engage an accountant, for an additional fee, to provide services which specifically focus on identifying and addressing weaknesses in internal controls and searching for the existence of fraud. However, these services are not part of an audit engagement.

### ***Review Engagements***

The second paragraph of the reviewer's standard report states:

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit 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. Accordingly, we do not express such an opinion.

The third paragraph states: "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."

In these paragraphs, the reviewing CPA is stating that, based only on the very limited (compared to an audit) procedures performed, he is not aware that the financial statements need to be adjusted materially.

The standards do require him, however, to perform additional procedures if, in the course of conducting his inquiries and analytical procedures, he encounters items or matters which are "incorrect, incomplete or otherwise unsatisfactory." The additional procedures can run the gamut from simply asking some more questions to, given unsatisfactory answers, performing some audit-type procedures.

Typical inquiries follow. What are your procedures for recording, classifying and summarizing information? Was \$xxx in the bank? Were the receivables valued properly (take into account bad debts)? Did you own the vehicles? Were all accounts payable recorded? Sometimes the CPA doesn't have to ask questions if he already knows the answer from other experience. But he always has to ask some questions in a review engagement.

Typical analytical procedures follow. Compare this year's sales with last year's and explain the difference. Compare this year's gross profit with the last year and explain the difference. Compare this year's interest expense with average outstanding debts to see if it makes sense.

The standards do not require a reviewing CPA to design his review to provide reasonable assurance of detecting material errors, irregularities, and illegal acts. Nor do the standards require reviewing CPA to design his review to provide any assurance of detecting error or fraud that is immaterial. The only items he is responsible for are those that are discoverable in the ordinary conduct of his review and follow-up. Even so, he would not be responsible if he received satisfactory answers to his follow-up questions.

## ***Compilation Engagements***

The second paragraph of the standard report for compilation engagements states:

A compilation is limited to presenting in the form of financial statements information which is the representation of management (owners). We have not audited or reviewed the accompanying financial statements and, accordingly, do not express any form of assurance on them.

Compilation engagements do not require the performance of any procedures. They do require the compiling CPA to read the financial statements to see if they are “appropriate in form and free from obvious material mistakes” in accounting and disclosures. This means that he must sniff the financial statements to see if anything material smells funny. But that’s all.

He might find apparent inconsistencies; for example, that the company has large receivables but no allowance for doubtful accounts. He might find that inventories are up substantially but accounts payable are down substantially and there has been no change in bank debt. He might find that the disclosures on long-term debt are insufficient. His course of action is to ask questions about these items and, if necessary, take further steps. Since he has performed no procedures, he has no responsibility for uncovering material errors, irregularities and illegal acts.

### **B. Preparation Of Income Tax Returns**

Accountants may also be retained to “prepare” federal, state and/or local tax returns for individuals or businesses (*i.e.*, partnerships, S Corporations, C Corporations, etc.) (collectively the “Taxpayer”). You might ask what does an accountant do as the “preparer” of my income tax return? What are my responsibilities in connection with the tax return? Does the preparing CPA verify the information I provide? Does the preparing CPA retain documentation supporting assertions in my tax return? This section examines these questions, among others, to help you better understand what your accountant does as the “preparer” of your tax returns, and what your obligations are as the Taxpayer.

#### ***What An Accountant Does When Preparing An Income Tax Return***

What the CPA “does do” in preparing an income tax return is evaluate and recommend tax positions, and complete the necessary documents for filing with the appropriate taxing authorities.

As part of the tax preparation process, the CPA identifies the questions that must be answered to complete the tax return and/or determines whether a particular tax position is appropriate. The CPA establishes relevant background facts necessary to answer these questions by communicating with the Taxpayer and/or reviewing documents the Taxpayer produces. The CPA may also search for and evaluate authority (such as federal or state statutes, opinions issued by tax authorities, or judicial opinions) to help the CPA arrive at a conclusion. The accountant then prepares each return in compliance with the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants.

In determining whether a certain tax position is warranted, the Statement on Standards for Tax Services requires the CPA to exercise professional judgment to determine whether there is a “realistic possibility” that a particular tax position will be sustained administratively or judicially on the merits. The “realistic possibility” standard is often quantified as a 33% chance or more of being sustained, although there is no definitive rule in this regard.

However, unless the accountant concludes that the tax position is “more likely than not” going to be sustained, he will likely require that the tax position be disclosed as part of the return before signing as the preparer. The Small Business and Work Opportunity Tax Act of 2007, imposes penalties on paid preparers of certain tax returns where an *undisclosed* tax position is asserted on a return for which the preparer cannot reasonably say in good faith that the position is more likely than not going to be sustained. The more likely than not standard is frequently quantified as a 50% chance or more of being sustained.

Sometimes the determination of whether a particular position meets the “realistic possibility” or “more likely than not” standard is not clear. For example, in exercising professional judgment, the accountant may conclude that competing tax positions both have a realistic possibility of being sustained. This situation may exist, for example, when a tax rule is ambiguous and no authority has resolved the ambiguity. In this circumstance, the CPA may discuss the competing positions with the Taxpayer, including the likelihood that each position might cause the Taxpayer’s tax return to be examined or result in a penalty. But, while the preparing CPA may provide advice or recommendations concerning a particular tax position, it is the Taxpayer’s ultimate responsibility to decide whether to assert the position on the income tax return.

### ***What An Accountant Does Not Do In Preparing An Income Tax Return***

Understanding a CPA’s role as the “preparer” of your income tax returns also requires understanding what services the CPA does not perform. What the CPA “does not” do in preparing income tax returns is audit, examine or verify the accuracy or completeness of information the Taxpayer provides, although when necessary the CPA may ask for clarification.

What this means is that the CPA will not ignore the implications of the information provided. If information appears incorrect, incomplete or inconsistent on its face or on the basis of other known facts, the CPA may bring them to the Taxpayer’s attention and ask for clarification. If necessary, the CPA may discuss or assist the Taxpayer to correct inaccurate or incomplete information. This, however, should not be confused with any procedures designed to detect errors, defalcations or other irregularities. The preparing CPA does not conduct any procedures designed to detect such problems.

The preparing CPA makes a reasonable effort to obtain from the Taxpayer information necessary to provide appropriate answers to questions on a tax return before signing as the preparer. But, it is ultimately the Taxpayer’s obligation to provide accurate, complete and timely information necessary to complete the tax return. For example, the CPA may ask questions or provide worksheets to guide the Taxpayer in gathering necessary information, but the CPA will not assist in gathering the information, and will rely on the information the Taxpayer provides.

The CPA also does not retain documents or data necessary to prove the accuracy and completeness of the returns to a taxing authority. Such documentation may become necessary if the Taxpayer’s return is selected for review by a taxing authority. The CPA cannot, and generally will not, consider whether such a review is likely to occur, except when there is a realistic possibility that two competing tax positions may be sustained.

As discussed above, the CPA may evaluate and make recommendations concerning the applicability of a particular tax position. The CPA may also provide other advice related to preparing the tax return. However, sometimes events may occur which affect the CPA’s previously provided advice. If there is such a change in advice, and the advice is associated with a plan or procedure for which the CPA is assisting the Taxpayer in implementing, the CPA will inform the Taxpayer of his or her change in position. But, if an event occurs that causes the CPA to change his advice and the Taxpayer is no longer implementing plans or procedures associated

with that advice, the CPA has no obligation to communicate with the Taxpayer concerning the change in advice unless he or she has otherwise agreed to do so. This means that a preparing CPA's advice at one time or during one taxable year may not be applicable at another time or during another taxable year.

### ***The Taxpayer's Responsibilities In Connection With Income Tax Returns***

The Taxpayer bears ultimate responsibility for the final tax return filed, including any income, deductions, or credits claimed, as well as any other representations asserted. The return is the Taxpayer's, not the CPA's, because the transactions and information upon which the tax return is based are the Taxpayer's, not the CPA's.

In a business, it is the company who owns the assets, makes sales, and incurs expenses. Therefore, management is responsible for properly recording transactions in the books of accounts, safeguarding assets and for the substantial accuracy of the company's financial records.

In the case of an individual, it is the individual who recognizes income, invests money, and incurs expenses in purchasing a home, raising a child, or paying for an education. It is the individual's responsibility to monitor and document these transactions completely and accurately.

Because it is the Taxpayer who monitors and documents their transactions, it is the Taxpayer's responsibility to ensure that the information provided to the preparing CPA is complete and accurate. The Taxpayer effectively enables the CPA to complete the return and evaluate the applicability of available tax positions by providing all necessary information to complete the return. The preparing CPA relies on the Taxpayer's oral and written representations. The preparing CPA does not audit or verify the Taxpayer's representations.

The preparing CPA cannot predict whether the Taxpayer's return will become the subject of review by taxing authorities. However, if the Taxpayer's return does become the subject of a review the Taxpayer will need to produce the necessary information to prove the accuracy and completeness of the tax return. While the accountant will be available to advocate the Taxpayer's position, it is the Taxpayer's responsibility to retain documentation and other data necessary for this purpose.

### **C. Consulting Services**

The accountant's role when performing management or business consulting services varies widely depending on the nature and scope of the work involved, which is determined solely by agreement between the CPA and the client. For this reason it is impossible to define the roles of the accountant and management for all types of consulting engagements. However, a general understanding of the types of consulting services a CPA provides and the analytical approach involved in providing such services may be helpful when considering what consulting services may serve to benefit your company's needs.

Consulting services differ fundamentally from a CPA's function in an attest engagement, such as an audit or review. In an attest engagement the CPA expresses conclusions (in the form of reasonable or limited assurance) about written assertions that are the responsibility of another party, the assertor. In a consulting engagement, the CPA *develops* the findings, conclusions, and recommendations presented by utilizing his technical skills, education, observations, experience and knowledge of the "consulting process."

The consulting process involves some combination of activities relating to determining the company's objectives, independent fact-finding, defining problems and/or opportunities, evaluating alternatives, forming a proposed action plan, communicating results, and implementing a plan and/or following-up on an implemented course of action. These activities are generally performed only for the use and benefit of the company.

Consulting services can come in many different forms, including consultations, advisory services, implementation services, or transaction services, among others. In a consultation engagement, the CPA's role is typically to provide, in a short time frame and based primarily on his or her personal knowledge about the client, information and analysis concerning technical matters, the intent of the parties, and/or client representations. Examples of consultations include a CPA's review and comment on a client-prepared business plan, or suggestions about computer software for further investigation.

When providing advisory services the CPA develops findings, conclusions and recommendations for management's consideration and decision making. An analysis about a company's accounting system or a review of a company's operations are two examples of advisory services that a CPA might provide.

When a consulting CPA provides implementation services, the CPA's function is to put an action plan into effect. The CPA may utilize both his own resources, as well as those of the client to achieve the client's objectives. Examples of implementation services include assisting with the implementation of steps to improve a company's productivity or assisting with the merger of organizations.

Finally, in a transaction consulting service the CPA provides services related to a specific transaction. For example, the CPA may provide an analysis of a potential merger, or may provide litigation services, including the rendering of an opinion based on conduct of another party or business.

Because there is such a wide variation in the types of available consulting services, hiring a CPA to provide business and management consulting services is unlike hiring an accountant to perform an audit, review, or compilation, or to prepare a tax return. The roles and responsibilities of both the accountant and client are less defined at first, but they are also more flexible. It is up to the accountant and management to develop a mutual understanding of the responsibilities of the parties, as well as the nature, scope, and limitations of services to be performed.

## **Conclusion**

What level of service does your accountant perform for you? Do these services meet your expectations or business needs? You may wish to consider whether basic tax return preparation is enough, or whether you need specialized consulting services to address a particular business problem. You may also wish to consider whether you are content with receiving no assurance (compilation), limited assurance (review), or reasonable assurance (audit) as to whether your financial statements are presented fairly. Further, if you need services intended to identify internal control weaknesses, or possible fraud, you should speak with your accountant about additional procedures necessary for these purposes. If you have any questions about whether you may need different or additional services, please give your accountant a call.

## **APPENDIX B**

### **Form Engagement Letters for Audit, Review and Compilation Agreements**

#### **(Form Audit Engagement Letter)**

*This engagement letter may not be appropriate for public company engagements regulated by the SEC. You should consult with legal counsel to ensure compliance with SEC regulations in all public company engagements.*

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

We are pleased to confirm our understanding of our engagement to provide services for [Client].

#### **1. Scope of Work**

We have been engaged to audit, in accordance with generally accepted auditing standards, the financial statements of [Client] as of [Date]. This engagement is predicated upon our understanding that [Client] meets the following preconditions for an audit: (1) that management uses an acceptable financial reporting framework in the preparation and fair presentation of its financial statements; and (2) that management and all others charged with the governance of [Client] agree with the premise upon which this audit will be performed, as more fully outlined below in "Management Responsibilities." We require agreement of both management and others responsible for the governance of [Client]. Kindly signify agreement by signing and returning one copy of this engagement letter.

If you have any reservations about whether [Client] meets these preconditions, do **not** sign this letter, but instead bring these concerns to our attention. After you sign this Engagement Letter if you become aware of concerns as to whether [Client] meets these preconditions, you agree to promptly and fully bring such matters to our attention.

#### **2. Management Responsibilities**

In accordance with our profession's Professional Standards, we must obtain your agreement as to the scope of your responsibilities in connection with this engagement. It is your responsibility to provide an internal control structure, including a control environment, an accounting system and control procedures, which will result in the production of financial statements that fairly present financial position, results of operations, and cash flows in conformity with an acceptable financial reporting framework; in this case, Generally Accepted Accounting Principles as in effect in the United States of America, as pertain to general purpose financial statements for businesses not audited under the regulations of the Securities Exchange Commission or the Public Companies Accounting Oversight Board. If in the course of this audit we discover deficiencies in this reporting framework that indicate the framework is unacceptable, and use of that framework is not required by law or regulation, management may decide to change that framework, subject to [Client] and our agreement upon new terms of the audit engagement that reflect such change in framework.

You are responsible for the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of the financial statements that are free from material misstatement, whether due to fraud or error. Financial statements which are produced thereby are your financial statements, not ours. You are responsible for them. It is your responsibility to adjust financial statements to correct material misstatements, and for ensuring that [Client] complies with the laws and regulations applicable to its activities.

It is equally [Client]'s responsibility to provide us with (1) access to all information of which [Client]'s management is aware that is relevant to the preparation and fair presentation of the financial statements such as records, documentation and other matters; (2) additional information that we may request for the purpose of the audit; and (3) unrestricted access to persons within [Client]'s organization or otherwise within [Client]'s control from whom we determine it is necessary to obtain audit evidence. It is management's responsibility to make all financial records and related information available to the auditor in a timely fashion. Your failure to do so may prevent or delay the completion of this engagement. It is also management's responsibility to advise us of events occurring or facts discovered after the date of the financial statements of which management may be aware that may affect financial statements.

It is our understanding that [Client] is not required by law or regulation to impose any limitation on the scope of our work as an auditor in performing this audit engagement. Any such limitation may affect our willingness to accept this engagement, and may result in our issuing a disclaimer of opinion based upon any such scope limitation. Please advise us immediately if you are aware of any such limitation on the scope of our work on this engagement.

Our responsibility is to audit your financial statements in accordance with professional standards. Even though we may produce your financial statements, present you with draft financial statements, assemble your financial statements, and print them on our printers or forward them to you electronically or otherwise assist in preparing them, [Client]'s financial statements are inherently [Client]'s, since they summarize the transactions [Client] recorded in its business records. We are not a party to those transactions. We only audit a sample of them and the balances created by them.

### **3. Character and Limitations of an Audit**

Our audit will be performed in accordance with generally accepted auditing standards. Those standards require that we initially assess the risk that errors, irregularities and illegal acts may cause the financial statements to contain a material misstatement. This is necessary because we do not audit all the transactions and balances in the financial statements, only a selected portion of them, in some cases a very small portion. The cost for us to examine a large portion of them, or all of them of a certain category, or all of them in all categories, would be prohibitive. Consequently, there are risks, principal among them that a properly planned and performed audit may not detect some material misstatements in [Client]'s financial statements.

In making this initial assessment, we are required to consider management characteristics, operating and industry characteristics and engagement characteristics. While the auditing CPA assumes neither client dishonesty nor unquestioned client honesty, these considerations mandate your complete cooperation and honesty about your knowledge and understanding of the possibility of the existence of errors, irregularities and illegal acts, and of negative management, operating and industry characteristics. By signing this letter, you agree that you will provide this cooperation and that you will be totally honest with us.

At the outset, before we can accept this audit engagement to perform an audit, where there is a predecessor auditor, we request that [Client] authorize such predecessor to respond fully to our inquiries that will help us determine whether to accept this engagement. Your signature on this letter will serve to confirm that you have so authorized any predecessor auditor. We reserve the right to



decline this engagement or to withdraw from this engagement as we evaluate the implications of the predecessor's response to our inquiries.

Based on our initial assessment, and upon your cooperation and honesty, the standards require us to design the audit to provide reasonable, but not absolute, assurance that the financial statements are free from material misstatement, whether caused by errors, irregularities or illegal acts. However, because of the characteristics of irregularities, particularly those involving forgery and collusion, a properly designed and executed audit may not detect a material irregularity. While we are required to exercise due care and professional skepticism, since our opinion is based on the concept of reasonable assurance, we are not an insurer and our report does not constitute a guarantee.

The standards also do not require that our audit be designed, nor is it designed, to detect error or fraud that is immaterial to the financial statements. However, we will inform you of any errors, irregularities, or illegal acts that may come to our attention as well as any need to extend our procedures because of them and our estimate of their additional cost.

The discovery, subsequent to the date of our auditors' report, that one or more errors, irregularities or illegal acts causing the financial statements to contain one or more material misstatements, have occurred does not necessarily mean that our audit was not conducted in accordance with generally accepted auditing standards.

Since the financial statements are your financial statements, the representations (*i.e.*, the words and numbers) in them are your representations. We audit the significant assertions that are implicit in those representations. For example, inventories in the financial statements are stated at a certain amount and are described in a certain manner, perhaps accompanied by additional language in the notes to the financial statements. That is your representation about the inventories. Implicit in that representation are some assertions by you. You are asserting that the inventories exist, that they are valued in accordance with generally accepted accounting principles, that any liabilities associated with them are included in the financial statements, that all the inventories are included and that the words associated with the number make the disclosures conform with generally accepted accounting principles. For further example, sales are stated at a certain amount. You are asserting that that amount includes sales that occurred and that the amount includes all the sales for the period.

We audit those assertions considered to be significant, *i.e.* material. We are not required by the standards to audit those considered insignificant, although we may do so selectively. We are required by the standards to assess the inherent and internal control structure risks related to the significant assertions in determining the nature, extent and timing of our audit tests. For example, in testing whether your assertion that the inventory exists, we customarily observe your taking of that inventory and test-count a small sample of it to verify the correctness of your existence assertion. It goes without saying that the higher these risks are, the more extensive our testing will be, and therefore the higher your cost. The standards do not require that our audit be designed to provide assurance on internal control or to identify reportable conditions, although we will inform you of any reportable conditions that come to our attention. We will also keep you informed about our judgments as to which significant assertions, if any, require significant audit testing beyond what is generally customary.

You may separately engage us, for an additional fee, to provide services that focus on identifying and addressing weaknesses in internal controls and searching for the existence of fraud. To date, you have declined such services and only requested that we perform the audit services described in this letter.

The assessment of overall audit risk and the inherent and internal control structure risks related to significant assertions are a matter of professional judgment. We will exercise due professional care in assessing those risks. You should be aware of the fact that assessing risks is not

an exact science. Therefore, it is not inconceivable that others might reach different conclusions. This does not mean, however, that we have necessarily been wrong in judging those risks.

The auditors' standard report contains an opinion about the financial statements taken as a whole. It is not an opinion about the individual components in the financial statements. Under these circumstances, the audit tests for individual components are less than the tests that would be required to express an opinion on an individual component. A misstatement may be material in relation to an individual component's balance, but not be material in relation to the financial statements taken as a whole. You agree that you will inform us at the outset of this engagement whether you have any extraordinary concerns about any significant assertion(s) related to individual components so that we can consider whether it might be necessary to extend our procedures, even so far as to require us to do enough testing to enable us to issue a special report about it (them).

At the conclusion of our audit, we will require you to furnish us a letter (commonly referred to as a management representation letter) confirming your responsibility for your financial statements and certain other items and matters related to them. Management is responsible for affirming in this letter, among other things, that the effects of any uncorrected misstatements aggregated by us in this engagement are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. This letter is a required audit procedure prior to issuing our report.

An audit performed in accordance with generally accepted auditing standards contemplates an opinion that the financial statements present fairly, in all material respects, financial position, results of operations and cash flows in conformity with generally accepted accounting principles. However, facts and circumstances may require us to qualify that opinion, or to disclaim it, or to express an adverse opinion. Other facts and circumstances may require us to provide additional information in our report. We will inform you if and when we conclude that our report may need to be modified because of such facts and circumstances.

Absent reasonable justification, we will not agree to any change to the terms of this audit engagement, and will not agree to change our engagement from an audit to an engagement for a lower level of assurance (such as a review or a compilation).

#### **4. Third Party Use and Reliance**

You have advised us that the following entities, and **only** them, will use our report for the following purposes:

<i>(User)</i>	<i>(Purpose)</i>
---------------	------------------

You have also advised us of your knowledge as to whether any of these users have extraordinary concerns about any significant assertion(s) related to individual components so that we can consider whether it might be necessary to extend our procedures even so far as to require us to do enough testing to enable us to issue a special report about it (them).

**It is not our intent that users other than those listed above will rely on our audit report. The use of our audit report by persons or entities other than those listed above is prohibited without our express written consent. We do not assume or accept any responsibility to third parties who are not disclosed to us. Should it become necessary for you to send our report to additional users, you must so advise us in writing immediately. However, we cannot be responsive to the extraordinary concerns of such additional users.**

We have furnished you a copy of our communication entitled "What We Do." We require that you send a copy to each user who has been furnished a copy of our auditors' report.

## 5. **Billing**

Our fees for this engagement will be based on time expended at our standard hourly rates. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the term of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [Insert Firm Billing Practice (i.e., monthly, per project, etc.)]. Our invoices are payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

*[Insert Any Additional Billing Practices Of Audit Firm]*

## 6. **Termination of Engagement**

Circumstances may arise during the engagement that may prevent the completion of the engagement, or require us to withdraw from the engagement. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

## 7. **Limited Liabilities and Indemnification**

By signing this Engagement Letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. Finally, you promise to notify us in writing before sending our audit report to any additional user not identified in Section 4 above. You acknowledge that these provisions are the cornerstone of [Client]'s relationship with us, are made to induce [Audit Firm] to accept this audit engagement, and that [Audit Firm] would not accept this audit engagement without such promises.

*[Use the Following Express Limited Liability and Indemnification Language Where Permitted Under Federal, State, Local and/or Professional Regulations: [Client] also agrees to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations or omissions, or the failure to fulfill any of [Client]'s responsibilities described in this engagement letter.]*

## 8. **Dispute Resolution**

By signing this engagement letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association that pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually agreeable to both parties.

*[Use the Following Additional Limited Liability Language Where Permitted Under Federal, State, Local and/or Professional Regulations: The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions that fail to comply with our professional standards in all material respects.]*

This Engagement Letter shall have the effect of a signed contract under the internal substantive law of the State of XXXX (without regard to conflict of law or choice of law provisions).

**9. Confidentiality and Third Party Requests For Information**

Work papers and audit documentation prepared by us in connection with this engagement are property of [Audit Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

**10. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Audit Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Audit Firm].

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Audit Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

Several technical accounting and auditing words and phrases have been used herein. We presume you to understand their meaning or that you will notify us otherwise so that we can furnish appropriate explanations.

Please acknowledge your acceptance of the terms of this engagement by signing this letter and returning the executed copy to us.

Very truly yours,

[Name and Title of CPA]  
[Audit Firm]

Acknowledged and Agreed to By:

[Name of Client Company]

By: \_\_\_\_\_ [Name  
and Title of Duly Authorized Agent of  
Company]

Date: \_\_\_\_\_

**(Form Review Engagement Letter)**

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

We are pleased to confirm our understanding of our engagement to provide services for [Client].

**1. Scope of Work**

We have been engaged to perform a review of the financial statements of [Client] as of [Date].

**2. Management Responsibilities**

At the outset, it is imperative that we state the scope of your responsibilities in connection with this engagement. It is your responsibility to provide an internal control structure, including a control environment, an accounting system and control procedures, which will result in the production of financial statements that fairly, present your financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. Financial statements which derive from your accounting system are your financial statements, not ours. You are responsible for them. It is your responsibility to adjust financial statements to correct material misstatements, and for ensuring that [Client] complies with laws and regulations applicable to its activities. Our objective is to review your financial statements in accordance with professional standards, to provide limited assurance that no material modifications are needed to those financial statements. Even though we may print or otherwise prepare your financial statements, or assist in preparing them, they are inherently your financial statements since they are based on your transactions as recorded in your accounting system. We are not a party to those transactions. We only make inquiries about them and the balances created by them, and perform analytical procedures with them. It is management's responsibility to make all financial records and related information available to us in a timely fashion, and to provide us with a representation letter, so that we may rely upon important representations made by you concerning your accounting system and financial statements. Your failure to meet these responsibilities may prevent or delay the completion of this engagement.

**3. Character and Limitations of a Review**

Our review will be performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. These standards require that we perform only certain inquiries of company personnel and certain analytical procedures applied to financial data. This limited scope is substantially less than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Consequently, a review engagement does not result in the expression of an opinion. As a matter of fact, an opinion is disclaimed.

Review engagement standards require that we possess knowledge about your accounting principles and accounting system as well as a general knowledge and understanding about your business. Most of this knowledge and understanding is gained through inquiries. The standards also require that we make inquiries about aspects of the significant components in your financial statements. By signing this letter, you agree that you will provide us your complete cooperation and that you will be totally honest with us in responding to our inquiries.

This engagement is not an audit. Audit engagement standards require that we assess the various risks associated with the engagement and the financial statements under audit, including as assessment of the risk of fraud. Then those standards require that we make various tests to verify financial statement components. Those tests include, among other things, confirmation, observation, inspection, inquiries and analytical procedures, and gathering of evidence. None of these measures are performed in a review. Likewise, an audit requires that we obtain an understanding of your system of internal control; no such requirement applies to a review.

In contrast, review engagement standards only require that we perform inquiries and analytical procedures. A review does not contemplate obtaining an understanding of internal control or assessing fraud risk, testing accounting records and obtaining evidence through inspection, observation, confirmation, or the examination of source documents. Nor does a review engagement involve the performance of other procedures ordinarily performed in an audit. For example, audit procedures for inventories include testing the counting and pricing, verifying the liabilities related to the inventories by inspecting invoices, etc. Review engagement procedures require only that we ask questions about these items and apply certain analytical procedures to them.

Moreover, a review engagement is not designed to provide any assurance of detecting errors, irregularities and illegal acts. However, we expect your complete cooperation and honesty about your knowledge and understanding of the possibility of their existence. By signing this letter, you agree that you will provide this cooperation and that you will be totally honest with us about these items.

You may separately engage us, for an additional fee, to provide services that focus on identifying and addressing weaknesses in internal controls and searching for the existence of fraud. To date, you have declined such services and only requested that we perform the services described in this engagement letter. However, we will inform you of any errors, irregularities, or illegal acts that may come to our attention as well as any need to extend our procedures because of them and our estimate of their cost.

The discovery, subsequent to the date of our review report, that one or more errors, irregularities or illegal acts causing the financial statements to contain one or more material misstatements, have occurred does not necessarily mean that our review was not conducted in accordance with professional standards.

The review engagement standards do require that if we become aware that information coming to our attention is incorrect, incomplete or otherwise unsatisfactory, we are to perform additional procedures. The nature and extent of such additional procedures will vary from very little to a great deal depending on the circumstances. If we feel it is necessary to perform significant additional procedures, we will inform you and advise you of the additional estimated cost of this engagement.

You may have extraordinary concerns about aspects of one or more material components in the financial statements in which case you may require that we perform some additional procedures. We request that you inform us about such a matter at the outset of the review so that we can decide the nature and extent of such additional procedures and whether they are so

extensive as to require a special report. If your requirement for us to perform additional procedures is very extensive, you may want to consider engaging us to perform an audit instead of a review.

The representations (*i.e.*, words and numbers) in the financial statements are your representations. Consequently, at the conclusion of our review, we will require you to furnish us a letter (commonly referred to as a management representation letter) confirming your responsibility for your financial statements and certain other items and matters related to them. This letter is a required review procedure prior to issuing our report.

A review report contemplates an expression of limited assurance, *i.e.*, that we are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. If a review engagement finds that material modifications should be made, then exceptions are taken and the modifications are described in the review report. The report may also include language inviting attention to items and matters in or about the financial statements.

#### **4. Third Party Use and Reliance**

You have advised us that the following entities, and only them, will use our review report for the following purposes:

<i>(User)</i>	<i>(Purpose)</i>
---------------	------------------

You have also advised us of your knowledge as to whether any of these users have extraordinary concerns about material financial statement components so that we can consider whether it might be necessary to extend our procedures even so far as to require us to do enough work to enable us to issue a special report about it (them).

**It is not our intent that users other than those listed above will rely on our review report. The use of our review report by persons or entities other than those listed above is prohibited without our express written consent. We require that third party users sign a third-party user agreement, which contains language similar to this engagement letter, setting forth the duties and responsibilities of the accountants, management, and the third-party user. We do not assume or accept any responsibility to third parties who are not disclosed to us or who do not enter into a third party user agreement with us. Should it become necessary for you to send our report to additional users, you must so advise us in writing immediately. However, we cannot be responsive to the extraordinary concerns of such additional users. You shall be liable to indemnify us for any liability, cost or expense that may be imposed upon us as a consequence of your violation of these provisions relating to Third Party Use and Reliance.**

We have furnished you a copy of our communication entitled: "What We Do." We require that you send a copy to each user who has been furnished a copy of our review report.

#### **5. Billing**

Our fees for this engagement will be based on time expended at our standard hourly rates. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the terms of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [Insert Firm Billing Practice (i.e., monthly, per project, etc.)]. Our invoices are

payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

*[Insert Any Additional Billing Practices of Reviewing Firm]*

## **6. Termination of Engagement**

Circumstances may arise during the engagement that may prevent the completion of the engagement, or require us to withdraw from the engagement. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

## **7. Limited Liability and Indemnification**

By signing this engagement letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. Finally, you promise to notify us in writing before sending our review report to any additional user not identified in Section 4 above. You acknowledge that these provisions are the cornerstone of [Client]'s relationship with us, are made to induce [Reviewing Firm] to accept this review engagement, and that [Reviewing Firm] would not accept this review engagement without such promises.

*[Use the Following Express Limited Liability and Indemnification Language Where Permitted Under Federal, State, Local and/or Professional Regulations: You also agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations or omissions, or the failure to fulfill any of their responsibilities described in this engagement letter, to the fullest extent allowed by law.]*

## **8. Dispute Resolution**

By signing this Engagement Letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually agreeable to both parties. The arbitration shall be conducted at the following locale: [City, State].

*[Use the Following Additional Express Limited Liability Language Where Permitted Under Federal, State, Local and/or Professional Regulations: The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions that fail to comply with our professional standards in all material respects.]*

## **9. Confidentiality and Third Party Requests For Information**

Work papers and review documentation prepared by us in connection with this engagement are property of [Reviewing Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.



In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates for litigation or forensic services, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in obtaining advice, or in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

**10. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Reviewing Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Reviewing Firm]. We express our willingness to adapt this engagement letter for particular circumstances. Please contact us before you sign this Engagement Letter if you would like us to consider proposed modifications.

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Reviewing Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

Several technical accounting, auditing, and review engagement words and phrases have been used herein. We presume you understand their meaning or that you will notify us otherwise so that we can furnish appropriate explanations.

Please acknowledge your acceptance of the terms of this engagement by signing this letter and returning the executed copy to us. Thanks.

Very truly yours,

[Name and Title of CPA]  
[Reviewing Firm]

Acknowledged and Agreed to By:

**[Name of Client Company]**

By:

\_\_\_\_\_  
[Name and Title of Duly Authorized Agent  
of Company]

Date:

\_\_\_\_\_

## **(Compilation Engagement Letter)**

[Date]

[Name]  
[Address]  
[City, State, Zip]

Dear [Name]:

We are pleased to confirm our understanding of our engagement to provide services for [Client].

### **1. Scope of Work**

We have been engaged to compile, from information you provide, the annual [*and interim, if applicable*] balance sheet and related statements of income, retained earnings and cash flows of [Client] for the year [Insert Year]. This means we will take your financial statements and will prepare a presentation of those financial statements which conforms with the generally accepted formats for the reporting of financial information.

### **2. Management Responsibilities**

At the outset, it is imperative that we state the scope of your responsibilities in connection with this engagement. It is your responsibility to provide an internal control structure, including a control environment, an accounting system and control procedures, which will result in the production of financial statements that present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. Financial statements which are produced thereby are your financial statements, not ours. You are responsible for them. It is your responsibility to adjust financial statements to correct material misstatements, and for ensuring that [Client] complies with laws and regulations applicable to its activities.

Our objective is to compile your financial statements based on information you provide and in accordance with professional standards. Even though we may prepare your financial statements, or assist in preparing them under a separate engagement letter, they are inherently your financial statements since they are based on your transactions. We are not a party to those transactions. We only perform the very limited services required by the standards for compilation engagements. It is management's responsibility to make all financial records and related information available to us in a timely fashion. Your failure to do so may prevent or delay the completion of this engagement.

### **3. Character and Limitations of a Compilation Engagement**

Our compilation will be performed in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. These standards require that we possess certain basic knowledge about your accounting principles and practices, records and personnel as well as a general understanding of your business transactions. In those connections, we may need to ask some questions. By signing this letter, you agree that you will be totally honest in answering them. The only other

requirement is that we read the financial statements (which may have also been prepared by us) to consider whether they are appropriate in form and free from obvious material errors, *i.e.*, arithmetic or clerical mistakes and mistakes in the application of accounting principles, including inadequate disclosure.

Bear in mind that a compilation is limited to assisting management to present financial information in the form of neutral statements. Presenting, in the form of financial statements, information that is the representation of management. We will not audit or review the financial statements and, accordingly, will not express an opinion or any other assurance on them. We will, however, issue a limited accountant's report which will describe the scope and limitations of our work as described herein.

A compilation is substantially narrower in scope than a review or an audit, and involves fewer services than a review or an audit of financial statements. A compilation does not contemplate performing inquiry, analytical procedures, or other procedures performed in a review. Additionally, a compilation does not contemplate obtaining an understanding of the company's internal control; assessing fraud risk; testing accounting records by obtaining sufficient appropriate audit evidence through inspection, observation, confirmation, or the examination of source documents (for example, cancelled checks or bank images); or other procedures ordinarily performed in an audit. Accordingly, we will not express an opinion or provide any assurance regarding the financial statements being compiled. This means that our compilation services will provide **no assurance** as to the fair presentation of your financial position in your financial statements and **no assurance** as to the detection of fraud, errors, irregularities or illegal acts.

Even though we may prepare the financial statements, the representations (*i.e.*, words and numbers) in them are your representations since they are based on your transactions as you record them in your books and records. The compilation engagement standards do require that if, based on our knowledge or in reading the financial statements, we become aware that information is incorrect, incomplete or otherwise unsatisfactory; we are to obtain additional or revised information. If we feel that obtaining this information will take a significant amount of time, we will inform you and advise you of the additional estimated cost.

On the other hand, you may have extraordinary concerns about aspects of one or more material components in the financial statements in which case you may require that we perform some additional procedures. We request that you inform us about such a matter at the outset of the compilation engagement so that we can decide the nature and extent of such additional procedures and whether they are so extensive as to require a special report.

If your requirement for additional procedures is very extensive, you may want to consider having us perform either an audit or a review. Audit engagement standards require that we assess the various risks associated with the engagement and the financial statements under audit. Then those standards require that we make various tests to verify financial statement components. Those tests include, among other things, confirmation, observation, inspection, inquiries and analytical procedures.

Review engagement standards only require that we perform inquiries and analytical procedures. For example, audit procedures for inventories include testing the counting and pricing, verifying the liabilities related to the inventories by inspecting invoices, etc. Review engagement procedures require only that we ask questions about these items and apply certain analytical procedures to them. None of these procedures are required for a compilation engagement.

A compilation engagement is not designed to provide any assurance of detecting errors, irregularities or illegal acts. However, we expect your complete cooperation and honesty about your knowledge and understanding of the possibility of their existence. By signing this letter, you agree that you will provide this cooperation and that you will be totally honest with us about such possibilities.

You may separately engage us, for an additional fee, to provide services that focus on identifying and addressing weaknesses in internal controls and searching for the existence of fraud. To date, you have declined such services, and only requested that we perform the services described in this engagement letter. However, we will inform you of any errors, irregularities, or illegal acts that may come to our attention as well as any need to extend our procedures because of them and our estimate of their cost.

The discovery, subsequent to the date of our compilation report, that one or more errors, irregularities or illegal acts causing the financial statements to contain one or more material misstatements, have occurred does not necessarily mean that our compilation engagement was not performed in accordance with professional standards.

Our compilation report will state the following:

“Management is responsible for the accompanying financial statements of [Client], which are comprised of the balance sheet as from [Date] to [Date] and the related income statements, changes in shareholders’ equity and cash flow for the noted period, and related notes to the financial statements in accordance with accounting principles generally accepted in the United States. Our work will be in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants (AICPA). I (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.”

Our report may also need to state our awareness of omitted disclosures or departures from generally accepted accounting principles, or may need to invite attention to items and matters in, or about, the financial statements. This includes cases where the financial statements are prepared in conformity with a special purpose framework, such as tax basis accounting. Our compilation report will also state if we believe our independence is impaired. As of the date of this letter, we [are/are not] aware of a potential impairment of our independence.

#### **4. Third Party Use and Reliance**

You have advised us that the following entities, and **only** them, will use our compilation report for the following purposes:

<i>(User)</i>	<i>(Purpose)</i>
---------------	------------------

**It is not our intent that users other than those listed above will rely on our compilation report. The use of our compilation report by persons or entities other than those listed above is prohibited without our express written consent. We require that third party users sign a third-party user agreement, which contains language similar to this engagement letter, setting forth the duties and responsibilities of the accountants, management, and the third-party user. We do not assume or accept any responsibility to third parties who are not disclosed to us or who do not enter into a third party user agreement with us. Should it become necessary for you to send our report to additional users, you must so advise us in writing immediately. However, we cannot be responsive to the extraordinary concerns of such additional users. You shall be liable to indemnify us for**

**any liability, cost or expense that may be imposed upon us as a consequence of your violation of these provisions relating to Third Party Use and Reliance.**

We have furnished you a copy of our communication entitled "What We Do." We require that you send a copy to each user who has been furnished a copy of our compilation.

## **5. Billing**

Our fees for this engagement will be based on time expended at our standard hourly rates. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the terms of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [Insert Firm Billing Practice (i.e., monthly, per project, etc.)]. Our invoices are payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

*[Insert Any Additional Billing Practices of Compiling Firm]*

## **6. Termination of Engagement**

Circumstances may arise during the engagement that may prevent completion of the engagement or require us to withdraw from the engagement. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

## **7. Limited Liability and Indemnification**

By signing this Engagement Letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. Finally, you promise to notify us in writing before sending our compilation report to any additional user not identified in Section 4 above. You acknowledge that these provisions are the cornerstone of [Client]'s relationship with us, are made to induce [Compiling Firm] to accept this compilation engagement, and that [Compiling Firm] would not accept this compilation engagement without such promises.

*[Use the Following Express Limited Liability and Indemnification Language Where Permitted Under Federal, State, Local and/or Professional Regulations: You also agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations or omissions, or the failure to fulfill any of their responsibilities described in this engagement letter.]*

## **8. Dispute Resolution**

By signing this engagement letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually agreeable to both parties. The arbitration shall take place at the following locale: \_\_\_\_\_.

*[Use the Following Additional Express Limited Liability Language Where Permitted Under Federal, State, Local and/or Professional Regulations:* The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties

#### **9. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Compiling Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates for forensic or litigation services, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

#### **10. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Compiling Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Compiling Firm]. We express our willingness to adapt this engagement letter for particular circumstances. Please contact us before you sign this Engagement Letter if you would like us to consider proposed modifications.

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Compiling Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

Technical accounting words and phrases have been used herein. We presume you understand their meaning or that you will notify us otherwise so that we can furnish appropriate explanations.

Please acknowledge your acceptance of the terms of this engagement by signing this letter and returning the executed copy to us.

Very truly yours,

[Name of CPA]  
[Compiling Firm]

Acknowledged and Agreed to By:

**[Name of Client Company]**

By:

\_\_\_\_\_  
[Name and Title of Duly Authorized Agent  
of Company]

Date: \_\_\_\_\_

## **APPENDIX C**

### **Form Tax Return Preparation Engagement Letter** **[Not Intended for Individual Tax Return Engagements]**

[Date]

[Name]  
[Address]  
[City, State, Zip]

Dear [Name]:

This letter is to confirm and specify the terms of our engagement with [Client] for the year ended 20XX and to clarify the nature and extent of the services we will provide. Also, by sending you this engagement letter we have assumed that you are the person responsible for the tax matters of the [Client]. If this is not a correct assumption, please furnish us with the name of the individual with whom this work should be coordinated.

#### **1. Character and Limitations of Services to be Provided**

Our engagement will be designed to perform the following services:

- (a). Prepare the federal, state, and local income tax returns with supporting schedules.
- (b). Perform any bookkeeping we find necessary for preparation of the income tax returns.

The completion of our tax services will be performed in accordance with the Statements on Standards for Tax Services issued by the American Institute of Certified Public Accountants. We will use our judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we will resolve such questions in your favor whenever possible.

Our work in connection with the preparation of your income tax returns does not include any procedures designed to discover defalcations or other irregularities, should any exist. Management is responsible for the proper recording of transactions in the books of accounts, for the safeguarding of assets, and for the substantial accuracy of the financial records. You may separately engage us, for an additional fee, to provide services that focus on identifying and addressing weaknesses in internal controls and searching for the existence of fraud. However, to date, you have declined such services and requested only that we perform the services described above.



[Client] has the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign and file them. It is management's responsibility to timely provide all financial records and other information needed for our preparation of [Client]'s returns, although we will make a reasonable effort to obtain information from you that may be necessary to answer any questions we have. Your failure to provide timely and complete financial records or other information necessary to complete your returns may delay the completion of this engagement and/or negatively affect your tax position.

[Client]'s returns may be selected for review by the taxing authorities. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of such government tax examination, we will be available upon request to represent you and will render additional invoices for the time and expenses incurred.

The law provides various penalties that may be imposed when taxpayers understate their tax liability. If you would like information on the amount or circumstances of these penalties, please contact us.

## **2. Billing**

Our fees for this engagement will be based on time expended at our standard hourly rates. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX per hour. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the terms of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [*Insert Firm Billing Practice (i.e., monthly, per project, etc.)*]. Our invoices are payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

*[Insert Any Additional Billing Practices of Preparing Firm]*

## **3. Termination of Engagement**

Circumstances may arise during the engagement which may prevent the completion of the engagement or require our withdrawal. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

## **4. Limited Liability and Indemnification**

By signing this engagement letter, you agree that you will be completely truthful with us and that we may rely upon both oral and written statements and responses to questions. You acknowledge that these promises are the cornerstone of [Client]'s relationship with us, are made to induce [Preparing Firm] to accept this tax preparation engagement, and that [Preparing Firm] would not accept this engagement without such promises.

You also agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by acts, errors or omissions in violation of our professional duties in all material respects, or the amount of the fees which you

pay for our services. Further, you agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from knowing misrepresentations by management.

## **5. Dispute Resolution**

By signing this engagement letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually acceptable to all parties.

The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties, and only to the extent they are less than the amount of fees which you pay for our services. If the amount of compensatory damages is greater than the amount of fees which you pay for our services, then the arbitrator(s)' authority to award compensatory damages shall be limited to the amount of fees paid.

## **6. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Preparing Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

## **7. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Preparing Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Preparing Firm].

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Preparing Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

If the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return it to our office. However, if there are additional returns you expect us to prepare, please note this at the end of the returned copy of this letter, just below your signature.

Very truly yours,

[Name and Title of CPA]  
[Firm Name]

Acknowledged and Agreed to By:

**[Name of Client Company]**

By: \_\_\_\_\_  
[Name and Title of Duly Authorized Agent of Company]

Date: \_\_\_\_\_

## **APPENDIX D**

### **Form Engagement Letter For Litigation Services**

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

The purpose of this letter is to summarize our understanding of the assistance that [Consulting Firm] has agreed to provide you and your client, in the matter of [Caption of Case Being Litigated] before the [Name of Court], which matter is [Case No. XXXXXX].

You have requested that we assist you with [Describe Services To Be Provided (i.e., analysis, opinions, consultation, etc.)] in connection with the above referenced [civil/criminal] case.

We understand that you or your firm will advise us (with sufficient notice) as to the details of the work to be performed by us and the requirements for appearance in court. We may request information from you, your firm or your client as needed for completion of the above described services. However, it is ultimately the responsibility of you and your client to provide us with all information needed to complete this engagement. Your failure to provide necessary information in a timely manner may delay or prevent the completion of this engagement.

I will be responsible for the performance of our engagement with you and your client. My hourly billing rate is \$XXX. From time to time, if necessary, other professionals may also assist when appropriate and needed. The hourly rates for our professionals are in the following ranges: Senior managers and managers--\$XXX to \$XXX; senior accountants and senior consultants--\$XXX to \$XXX; and consultants--\$XXX to \$XXX. Our hourly rates are subject to change from time to time. We will advise you immediately if a rate adjustment is being made by our firm.

Fees for our services are based upon the actual time expended on the engagement at the standard hourly rates for individuals assigned. In addition to our professional fees, we are reimbursed at cost for any travel and out-of-pocket expenses. Our normal practice is to issue invoices [Insert Firm Billing Practices (i.e., monthly, per project, etc.)]. We reserve the right to defer rendering further services until payment is received on past due invoices.

We are certain that you recognize that it is difficult to estimate the amount of time that this engagement may require. The time involved is dependent upon the extent and nature of available information. It is also dependent upon the developments that may occur as work progresses. It is our intention to work closely with you to structure our work so that the

appropriate levels of personnel from our staff are assigned to the various tasks in order to keep fees at a minimum.

Circumstances may arise during this engagement which may prevent completion of this engagement, or require our withdrawal from the engagement. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

By signing this engagement letter, you, your firm and your client agree that any dispute concerning our services, including any fees charged by us, will be submitted for resolution by binding arbitration in accordance with the rules of the American Arbitration Association. The arbitrator(s) selected to preside over any arbitration must be mutually agreeable to all parties. In agreeing to arbitration, we each acknowledge that in the event of a dispute, each of us is giving up the right to have the dispute decided in a court of law before a judge or jury and instead are accepting the use of arbitration for resolution.

Work papers and other documentation prepared by us in connection with this engagement are property of [Consulting Firm]. However, we will not disclose confidential information of [Law Firm's Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Law Firm Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between us. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you, your firm and your client agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between us.

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Law Firm] and [Consulting Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

If the arrangements described in this letter are acceptable to you and the services outlined are in accordance with your requirements, please sign and return an executed copy of this letter. We look forward to working with you in this matter. If I can provide you with any additional information, please do not hesitate to call me.



## **APPENDIX E**

### **Form Engagement Letter For Obtaining Financing**

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

This letter outlines our understanding of the arrangements we made to assist [Client] in obtaining new financing.

#### **1. Nature and Scope of Work**

We shall perform a study of [Client]'s financing needs and the underlying reason(s) for these needs. Based on the study, we shall advise you concerning the sources of funds and methods of financing most appropriate to your finance needs. We shall assist you in evaluating the alternatives and in choosing the source and method best suited for you.

Once determining the amount of financing needed, the purpose, the source, and the method, we will then assist you [Describe Assistance to be Provided (i.e., prepare business plan, prepare documents for presentation to financing source, etc.)].

#### **2. Roles**

To provide an effective framework for this engagement, both parties must have a clear understanding of their respective roles. Our role encompasses:

[Describe Firm's Role. For example:

- Gathering data about\_\_\_\_\_.
- Analyzing\_\_\_\_\_.
- Assisting in evaluating\_\_\_\_\_.
- Assisting in preparing\_\_\_\_\_.
- Assisting in presenting\_\_\_\_\_.]

Your role encompasses:

[Describe Client Roles. For example:

- Providing financial and other records and data that we request.
- Making your key people available for interviews and conferences.
- Making timely decisions on the various aspects of this engagement as it progresses.

- Cooperating with our staff in completing this engagement.]

Our role is essentially one of assisting, evaluating, and advising. While we will exert our best effort, we offer no assurance that financing will be obtained.

### **3. Results and Benefits**

The tangible results of this engagement will be [Describe Tangible Work Product]. The intangible results of this engagement may include [Describe Any Intangible Results or Benefits].

### **4. Commencement and Scheduling of Work**

We are beginning work on this engagement immediately and expect to complete the engagement in approximately [Estimated Time of Completion]. However, we are sure you recognize it is difficult to estimate the time this engagement may require. This timetable is, therefore, only an estimate. It assumes adequate cooperation on the part of your personnel and the ready availability of the information and data required for completion of this engagement. Your failure to cooperate or provide all necessary information may delay or prevent completion of the engagement. Further, unanticipated events may arise requiring additional work and causing unexpected delay. We will inform you of any events that arise which may affect our estimated timetable for completion of this engagement.

### **5. Engagement Completion and Termination**

We will consider the engagement concluded when [Define When Engagement Will Be Deemed Complete]. We will provide you with a letter at this time advising you that the engagement is complete.

Circumstances may arise during this engagement which may prevent the completion of the engagement or require our withdrawal from the engagement. If, during the course of the engagement, either of us becomes aware of facts or circumstances that would preclude a successful conclusion of the engagement, one party may terminate the engagement by notifying the other party in writing, subject on our part to any applicable rules of professional conduct.

### **6. Fees and Payments**

Our fees for this engagement will be based on time expended at our standard hourly rate of \$XXX per hour. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX. Although these rates are subject to change from time to time, we do not anticipate any changes during the terms of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [Insert Firm's Billing Practice (i.e., monthly, bi-monthly, etc.)]. Our invoices are payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.



[Insert Any Additional Billing Practices Of Consulting Firm]

**7. Limited Liability and Indemnification**

By signing this engagement letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. You acknowledge that these promises are the cornerstone of [Client]'s relationship with us, are made to induce [Consulting Firm] to accept this consulting engagement, and that [Consulting Firm] would not accept this engagement without such promises.

You also agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by acts, errors or omissions in violation of our professional duties in all material respects, or the amount of the fees which you pay for our services. Further, you agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from knowing misrepresentations by management.

**8. Dispute Resolution**

By signing this engagement letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually agreeable to both parties.

The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties, and only if those damages are less than the amount of fees which you pay for our services. If the amount of compensatory damages is greater than the amount of fees which you pay for our services, than the arbitrator(s)' authority to award compensatory damages shall be limited to the amount of such fees paid.

**9. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Consulting Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

**10. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Consulting Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Consulting Firm].

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Consulting Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

If any part of this letter differs from your understanding of this engagement, please notify us at once so that we can establish a proper mutual understanding. However, if the foregoing fairly sets forth your understanding, please sign the enclosed copy of this letter in the space indicated and return to our office.

Very truly yours,

[Name of CPA]

[Firm Name]

Acknowledged and Agreed to By:

[Name of Client Company]

By:

\_\_\_\_\_  
[Name and Title of Duly Authorized Agent  
of Company]

Date: \_\_\_\_\_

## **APPENDIX F**

### **[Financial Statement Engagement Letter] (SSARS 21- compliant)**

[Name]  
[Address]  
[City, State, Zip]

Dear [Name]:

We are pleased to confirm our understanding of our engagement to provide services for [Client].

#### **1. Scope of Work**

We have been engaged to prepare the financial statements of [Client], which comprise the balance sheet as of December 31, 20XX, and the related statements of income, changes in stockholder's equity, and cash flows for the year then ended and the related notes to the financial statements. We will conduct our engagement in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants (AICPA), including AR-C Section 70, *Preparation of Financial Statements*.

#### **2. Management Responsibilities**

At the outset, it is imperative that we state the scope of your responsibilities in connection with this engagement. It is your responsibility to provide us with accurate and complete records, documents, explanations and other information, including any significant judgments, necessary for us to prepare the financial statements (Information). You are also responsible for an internal control structure, including a control environment, an accounting system and control procedures, which will result in the production of such Information. The financial statements which are produced by us are your financial statements, not ours. You are responsible for them. It is your responsibility to adjust financial statements, or further engage us under a separate arrangement, to correct material misstatements, and for ensuring that [Client] complies with laws and regulations applicable to its activities.

Our objective is to prepare your financial statements based on information you provide and in accordance with professional standards. Even though we have prepared your financial statements, they are inherently your financial statements since they are based on your transactions. We are not a party to those transactions. We only perform the very limited services required by the standards for preparing financial statements. It is management's responsibility to make all financial records and related information available to us in a timely fashion. Your failure to do so may prevent or delay the completion and success of this engagement.

### **3. Character and Limitations of a Financial Statement Preparation Engagement**

As noted above, the preparation of [Client's] financial statements will be performed in accordance with SSARS. These standards require that we possess certain basic knowledge about your accounting principles and practices, records and personnel as well as a general understanding of your business transactions. In those connections, we may need to ask some questions. By signing this letter, you agree that you will be totally honest in answering them.

We are not required to, and will not, verify the accuracy or completeness of the Information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. In addition, we will not compile, audit or review the financial statements. Accordingly, we will not express an opinion or a conclusion or provide any accountant's report or assurance on the financial statements, including that the financial statements are fair presentation of your financial position, or that there has been no detection of fraud, errors, irregularities or illegal acts.

The preparation of financial statements is substantially narrower in scope and involves fewer services than a compilation, review or an audit, and involves fewer services. This engagement is strictly limited to preparing financial statements in accordance with generally accepted standards in the United States. Additionally, preparation of financial statements does not require us to be independent. We will not obtain an understanding of the company's internal control, assess fraud risk, test accounting records through inspection, observation, confirmation, or the examination of source documents, or engage in other procedures ordinarily performed in a compilation, review or audit. However, if we become aware that information is incorrect, incomplete or otherwise unsatisfactory we will promptly advise you and will seek to obtain additional or revised information. If we feel that obtaining this information will take a significant amount of time, we will inform you and advise you of the additional estimated cost.

The preparation of financial statements is not designed to detect errors, irregularities, weaknesses in internal controls, fraud or illegal acts. You may separately engage us, for an additional fee, to provide such services. Presently, you have only engaged us to perform the services described in this engagement letter. However, we will inform you of any errors, weaknesses, irregularities, or illegal acts that may come to our attention, as well as any need to extend our procedures because of them and our estimate of their cost. Finally, we expect your complete cooperation and honesty about your knowledge and understanding of the possibility of their existence; and you agree to provide such cooperation and honesty.

The discovery, subsequent to the date of the financial statements, that one or more errors, irregularities or illegal acts causing the financial statements to contain one or more material misstatements, have occurred does not necessarily mean that our engagement was not performed in accordance with professional standards.

As required by SSARS, each page of the financial statements will include a statement substantially similar to the following: *No assurance is provided on these financial statements.*

In addition, if you choose not to include note disclosures in the financial statements usually included in financial statements prepared in accordance with generally accepted accounting principles, we are required to make this known to the user(s) through an appropriate statement that such disclosures have been omitted.

#### **4. Third Party Use and Reliance**

You have advised us that the following entities, and only them, will use the financial statements for the following purposes:

<i>(User)</i>	<i>(Purpose)</i>
---------------	------------------

You agree to include all legends which we have included in the financial statements in any copies that are provided to third parties.

#### **6. Billing**

Our fees for this engagement will be based on time expended at our standard hourly rates. Currently, these rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hourly rate is \$XXX. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the terms of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to issue invoices [Insert Firm Billing Practice (i.e., monthly, per project, etc.)]. Our invoices are payable on receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

[Insert Any Additional Billing Practices of Firm]

#### **6. Termination of Engagement**

Circumstances may arise during the engagement that may prevent completion of the engagement or require us to withdraw from the engagement. Either you or this firm may terminate the engagement at any time for any reason by written notice, subject on our part to any applicable rules of professional conduct.

## **7. Limited Liability and Indemnification**

By signing this Engagement Letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. Finally, you promise to notify us in writing before sending the financial statement to any additional user not identified in Section 4 above. You acknowledge that these provisions are the cornerstone of [Client]'s relationship with us, are made to induce us to accept this engagement, and that we would not accept this engagement without such promises.

You also agree to release, indemnify, defend and hold [Firm] harmless from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations or omissions, or the failure to fulfill any of their responsibilities described in this engagement letter. You further agree that our liability under this engagement shall be limited to the amount of fees paid to [Firm] for the services rendered hereunder, and shall not include any indirect damages. Any claim against [Firm] must be brought within 24 months after the alleged breach of the terms of this engagement letter occurred.

## **8. Dispute Resolution**

By signing this engagement letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the procedures and rules acceptable to the parties, including those specifically pertaining to the resolution of claims involving accountants. The arbitrator(s) selected to preside over any arbitration proceeding must be mutually agreeable to both parties, preferably with accounting industry experience. The arbitration shall take place at the following location: \_\_\_\_\_.

The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties.

## **11. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates for forensic or litigation services, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not

limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

## **12. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Firm]. We express our willingness to adapt this engagement letter for particular circumstances. Please contact us before you sign this Engagement Letter if you would like us to consider proposed modifications.

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

Technical accounting words and phrases have been used herein. We presume you understand their meaning or that you will notify us otherwise so that we can furnish appropriate explanations.

Please acknowledge your acceptance of the terms of this engagement by signing this letter and returning the executed copy to us.

Very truly yours,

[Name of CPA]

[Firm]

Acknowledged and Agreed to By:

**[Name of Client Company]**

By:

\_\_\_\_\_  
[Name and Title of Duly Authorized Agent  
of Company]

Date:

\_\_\_\_\_

## **APPENDIX G**

### **(Form Nonattest Engagement Letter For An Attest Client)**

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

This letter outlines our understanding of the agreement we reached to assist [Client] in [Describe General Nature of Engagement].

#### **1. Objectives of the Engagement**

The objective of this engagement is to [Describe Objectives of Engagement].

#### **2. Approach and Services to be Performed**

To efficiently complete the engagement, both parties need a clear understanding of their respective roles. Our firm will do the following:

[Describe Firm's Role. For example:

- Gather and analyze\_\_\_\_\_.
- Evaluate\_\_\_\_\_.
- Provide recommendations for\_\_\_\_\_.
- Examine\_\_\_\_\_.]

We will not make any management decisions or perform any management functions.

#### **3. Client's Responsibilities**

Your company will:

- Make all management decisions and perform all management functions.
- Designate an individual who possesses suitable skill, knowledge, and/or experience, preferably within senior management, to oversee our services.
- Evaluate the adequacy and results of the services we perform.
- Accept responsibility for the results of the services we provide.
- Establish and maintain internal controls, including monitoring ongoing activities.
- [Describe Any Other Client Responsibilities].



#### **4. Limitations of Engagement**

As you know, our firm has also been engaged to perform [Identify Attest Service] for [Client]. Therefore, we must ensure that in accepting this engagement we do not impair our independence. Although we may provide advice, research materials, and make recommendations to assist in your management of the company and your management decisions, we cannot and will not perform or be involved in any management decisions or functions.

#### **5. Engagement Staffing and Scheduling**

We expect to begin work on this project [Estimated Date], and complete it in [Estimated Date]. However, we are sure you recognize it is difficult to estimate the time this engagement may require. The above timetable is only an estimate. It assumes cooperation from your personnel and the ready availability of the information and data needed for completion of this engagement. Your failure to cooperate or timely provide necessary information may delay or prevent completion of this engagement. Unanticipated events may also require additional work and cause unexpected delay. We will inform you of any events that arise which may affect our estimated timetable for the commencement or completion of this project.

#### **6. Results and Benefits**

The tangible result of this engagement will be [Identify Tangible Results and Benefits]. The intangible results or benefits may include [Identify Potential Intangible Benefits].

#### **7. Engagement Completion and Termination**

We will consider the project concluded when [Define When Engagement Will Be Deemed Completed].

Circumstances may arise during this engagement which may prevent the completion of the engagement or require our withdrawal from the engagement. Therefore, either party may terminate the engagement by notifying the other party in writing, subject on our part to any applicable rules of professional conduct

#### **8. Fees, Billing Arrangements and Payments**

We base our fees for this engagement on the time spent at our standard hourly rate of \$XXX per hour. Currently, our rates range from \$XXX per hour for our most senior partners and \$XXX per hour for our new accountants. My hour rate is \$XXX. Although these billing rates are subject to change from time to time, we do not anticipate any changes during the term of this engagement.

Any out-of-pocket expenses will be billed in addition to our fees. Our normal practice is to [Describe Billing Practices (i.e., monthly, bi-monthly, etc.)]. Our invoices are payable upon receipt. We reserve the right to defer rendering further services until payment is received on past due invoices.

[Insert Any Additional Billing Practices of Consulting Firm]

**9. Limited Liability and Indemnification**

By signing this engagement letter, you promise to make every diligent effort to maintain proper books and records that accurately reflect [Client]'s business activities, that you will be completely truthful with us, and that we may rely upon both oral and written statements and responses to questions. You further promise to immediately advise us if [Client] becomes aware of any inaccuracy in any of its business dealings, including any of management's representations or statements to us. By signing this engagement letter, you agree that you will be completely truthful with us and that we may rely upon both oral and written statements and responses to questions. You acknowledge that these promises are the cornerstone of [Client]'s relationship with us, are made to induce [Consulting Firm] to accept this consulting engagement, and that [Consulting Firm] would not accept this engagement without such promises.

You also agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by acts, errors or omissions in violation of our professional duties in all material respects, or the amount of the fees which you pay for our services. Further, you agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from knowing misrepresentations by management.

**10. Dispute Resolution**

By signing this Engagement Letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) selected to preside over any arbitration must be mutually agreeable to both parties.

The arbitrator(s) shall have authority to award compensatory damages, but only for such damages as found to have been directly and solely caused by acts, errors, or omissions committed in violation of our professional duties, and only if those damages are less than the amount of the fees which you pay for our services. If the amount of compensatory damages is greater than the amount of fees which you pay for our services, than the arbitrator(s)' authority to award compensatory damages shall be limited to the amount of such fees paid.

**11. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Consulting Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

**12. Integration and Modification**

This engagement letter sets forth all of the agreed upon terms of our engagement with respect to matters covered in this engagement letter, and shall be treated as the entire agreement between [Client] and [Consulting Firm]. Any oral or written agreement, statement, representation or promise that is not contained in this engagement letter is invalid and unenforceable. By signing this engagement letter, you agree that the terms of this engagement letter supersede any oral or written agreement, statement, representation or promise between [Client] and [Consulting Firm] concerning our consulting engagement.

The terms of this engagement letter may not be modified in any respect unless in writing and signed by both [Client] and [Consulting Firm], and then such modification shall be effective only in the specific instance or purpose for which it is given.

Please acknowledge your acceptance of the responsibilities and terms of this engagement by signing this letter and returning an executed copy to us. Thanks.

Very truly yours,

[Name of CPA]  
[Firm Name]

Acknowledged and Agreed to By:

[Name of Client Company]

By:

\_\_\_\_\_  
[Name and Title of Duly Authorized Agent  
of Company]

Date: \_\_\_\_\_

## **APPENDIX H**

### **(Form Bookkeeping with restricted use Clause)**

<Date>

<Client Representative>

<Client Name>

<Client Address>

Dear <Client Representative>:

This letter is to confirm our understanding of the terms and objectives of our engagement with <Client Name> as well as the nature and limitations of the services we will provide.

#### **1. Character and Limitations of Services to be Provided**

Beginning with the month of <month>, we will perform the bookkeeping function of <Client Name> by recording all cash receipts and cash disbursements in Quicken (or similar check book computer program). <Client Name> will supply a fully functional and capable computer. <Client Name> agrees to provide us the following documents on a daily basis: cash receipt reports and deposit slips, purchase orders, invoices and miscellaneous cash disbursements; and on a monthly basis: bank statements, payroll and sales tax reports.

We will record cash receipts from <Client Name>'s daily cash receipt reports and deposit slips. We will not handle any cash or checks received nor make deposits. All daily cash receipt reports must be stamped "authorized by <Client Name>" and be accompanied by a deposit slip or bank receipt. <Client Name> must code all receipts as to the proper account number for recording into Quicken. We will supply monthly internal cash receipt reports upon request.

<Client Name> will open a P.O. Box for all correspondence (invoices, bills, bank statements, etc.) to be sent. We will have access to and will open all mail that is received in this box. <Client Name> will set up a complete system of checks and balances for the approval and payment of invoices. All packing or receiving slips will be stamped and initialed by an authorized employee verifying that the amounts received are accurate. All invoices must be accompanied by a purchase order or check authorization.

We will record all bills that <Client Name> or its representative has authorized. The payment will be made either by paper check or electronic payment (check free). We will not be responsible for the signing of checks nor the authorization for electronic funds transmissions. We will prepare a cash disbursements report from the outstanding bills. From this report <Client Name> will authorize us to make the payments.

Each month we will reconcile <Client Name>'s checking account with the bank statement for proper account balance and to identify any errors. We will make correcting entries directly into Quicken and identify the specific source of each adjustment. We will tell you of these adjustments and make you aware of any corrections if they pertain to employees.

We will process payroll for the 15th and last day of each month based on <Client Name>'s salary and hourly reports. We will need verification of time worked before processing the payroll. We will coordinate with the payroll service of <Client Name>'s choice and have them courier paychecks to your office directly. The checks are presigned. We will record the payroll and taxes into Quicken and reconcile to the quarterly reports. We will not make payroll tax deposits or prepare payroll tax returns. <Client Name>'s payroll service will be responsible for those.

We will prepare the quarterly sales tax returns from <Client Name>'s cash receipt reports. The actual transmittal of sales tax payments need to be made monthly and quarterly. We will incorporate this into the normal cash disbursements process.

On a periodic basis, as needed, and at least four times each year, we will meet with you to discuss your accounting records and cash controls. These meetings are important to the financial well-being of your company and should be held at least quarterly.

**We will document the results of this engagement in a report. You agree that this report will be used solely for the internal use of management and will not be distributed to outside parties.**

## **2. Work Paper Retention**

It is our policy to keep work papers related to this engagement for seven years. When records are returned, it is your responsibility to retain and protect them for possible future use, including potential examination by any government or regulatory agency.

## **3. Fees, Billing Arrangements and Payments**

Our fees for this monthly bookkeeping service will be \$<amount> per month plus out-of-pocket expenses. This includes the salary of a new full-time employee we will hire to handle this work. The employee will have a direct phone and fax line to communicate with <Client Name> personnel.

We will require a retainer prior to starting work. This retainer will cover fees for the initial start-up and transfer of your records to our office. A retainer of \$<amount> is necessary to begin work on this engagement.

This engagement does not include any personal accounting for <Client Name>. Any additional accounting services requested will be outlined in a separate engagement letter and billed separately. This may include, but is not limited to, business or personal accounting write-up work, financial statement compilation, or any compliance services including handling license or filing renewals.

This engagement does not include business management. We will not review the payment of any invoices or bills beyond the normal authorization stamp produced by your office. If an amount appears unusual or out of the ordinary we will call it to your attention, but we do not take any responsibility in the discovery of any errors, irregularities, or fraud.

Our fees will be based upon the amount of time required at our standard billing rates plus out-of-pocket expenses. Bookkeeping hourly rates vary from \$<amount> to \$<amount> per hour. Tax, financial, and consulting hourly rates vary from \$<amount> to \$<amount> per hour depending on the individual providing the services. All invoices are due and payable upon presentation. We will bill on an interim basis prior to completion of this engagement. Billings become delinquent if not paid within <number> days of the invoice date. If billings are past due in excess of <number> days, we will stop all work until your account is brought current, or withdraw from this engagement. <Client> acknowledges and agrees that we are not required to continue work in the event of <client's> failure to pay on a timely basis for services rendered as required by this engagement letter. <Client> further acknowledges and agrees that in the event we stop work or withdraw from this engagement as a result of <client's> failure to pay on a timely basis for services rendered as required by this engagement letter, we shall not be liable to <client> for any damages that occur as a result of our ceasing to render services.

#### **4. Confidentiality and Third Party Requests For Information**

Work papers and other documentation prepared by us in connection with this engagement are property of [Firm]. However, we will not disclose confidential information of [Client] contained in those work papers or otherwise disclosed to us during this engagement except when required by law or permitted under the rules of professional conduct governing accountants.

In the event that we are required to respond to a subpoena, court order, or other legal process for the production of documents and/or testimony relative to information obtained and/or prepared during the course of our engagement, you agree to compensate us at our hourly rates, as set forth above, for the time we expend in connection with such responses, and to reimburse us for all of our out-of-pocket expenses incurred in that regard, including but not limited to reasonable attorneys' fees incurred by us in connection with responding or objecting to the scope of an information request, or incurred as a result of [Client]'s refusal to provide written consent to produce subpoenaed documents or provide the required testimony.

#### **5. Limited Liability and Indemnification**

You also agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by acts, errors or omissions in violation of our professional duties in all material respects, or the amount of the fees which you pay for our services. Further, you agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from knowing misrepresentations by management.

#### **6. Dispute Resolution**

If a dispute arises among the parties hereto, the parties agree first to try in good faith to settle the dispute by mediation administered by the American Arbitration Association under its Rules for Professional Accounting and Related Services Disputes before resorting to litigation. The costs of any mediation proceeding shall be shared equally by all parties.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to me. Also have all authorized check signers sign in the space provided. Thank you for this opportunity to serve you.

Very truly yours,

---

<Accountant Name>

<Firm Name>

APPROVED:

---

<Client Name>

<Client Representative>

---

Date

Check Signing Authority

---

<Check Signer's Name>

---

Date

---

<Check Signer's Name>

---

Date

## APPENDIX I

### Form Reply Letters For Use After Receiving Notice Of Intended Third Party Use Of Audit, Review or Compilation Report

#### (Reply Letter To Client Accepting Third Party Use Of Audit Report)

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

As indicated in our audit engagement letter to you of [Date], our firm has been engaged to audit, in accordance with generally accepted auditing standards, the financial statements of [Client] (the "Company") as of [Date].

We understand and acknowledge:

- (a) the Company plans to provide [Additional User] with a copy of the audited financial statements for the period described above, and our report in which our opinion is expressed;
- (b) that [Additional User] has informed you that it intends to rely upon our opinion in connection with the following transaction: [Insert Details of Transaction]; and
- (c) that you intend that [Additional User] should so rely.

We wish to remind you that the Company has engaged us to render an opinion on the Company's financial statements for the above described period. So that we can render an opinion, we [will conduct/have conducted] an audit in accordance with generally accepted auditing standards. Our object [is/was] to determine whether the Company's financial statements present fairly, in all material respects, the Company's financial position in conformity with generally accepted accounting principles.

Under generally accepted auditing standards, we have the responsibility to design our auditing procedures to provide us with reasonable assurance that we will detect errors or irregularities that would have a material effect upon the financial statements. We also have the responsibility to conduct the auditing procedures with due care.



However, as we explained in our engagement letter, an audit is not a complete examination of every entry in the financial books of the Company. Rather, it involves selective testing. This necessarily involves judgment as to the number of transactions to be audited, the method of testing to be employed, and the acceptable tolerances of test results. All audits are subject to the risk that material errors or irregularities, if they exist, may not be detected. At the conclusion of the audit, [we expect to issue/we issued] an *opinion* as to whether the Company's financial statements fairly present, in all material respects, the financial position of the Company. This opinion should not be taken as a guaranty of the Company's financial position. Our opinion [will reflect/reflects] our considered judgment.

We previously furnished you a copy of our communication entitled "What We Do." You agreed to send a copy of that communication to each user who is furnished with a copy of our audit report. We understand that you [will do/have done] so. If we are incorrect, please advise us as soon as possible.

Because the design and conduct of the audit involves professional judgment, it is possible that others may assess various matters differently. This is particularly true when the user of a financial statement is especially concerned with components of the financial statement important to a particular transaction, rather than the financial statements as a whole.

Accordingly, items of possible interest to [Additional User] may not [have been/be] specifically addressed. Our audit [is not intended/was not conducted] for the benefit of [Additional User] and should not be taken to supplant the inquiries and procedures that [Additional User] should undertake for the purpose of satisfying itself as to the Company's credit worthiness or for other purposes associated with the above-described transaction.

We expect that [Additional User] has conducted its own due diligence investigation of the Company and will continue to do so in the future, including an analysis of the Company's current business activities, discussions with company management, consideration of non-financial and external factors which may impact upon the Company, and such other procedures as it may deem appropriate.

We wish to emphasize that management of the Company has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for safeguarding assets and for devising a system of internal control that will, among other things, help assure the preparation of proper financial statements. The financial statements are the representations of management. In forming our opinion on the Company's financial statements, [we intend to rely/have relied] on such management representations which, in our professional judgment, appropriately merit our reliance.

*[When Reliance Notice is Received Before Audit Planning Is Complete, Use The Following Additional Language: In light of your plans to provide [Additional User] with a copy of the above described financial statements and our opinion thereon, we expect to reexamine our audit plans and to determine whether additional procedures beyond those originally contemplated should be pursued. We believe this reevaluation is necessary so that our audit is*

*properly designed and conducted under these changed circumstances. This may cause additional expense to you, and may change the scheduling of our field work.]*

OR

*[When Reliance Notice is Received During Field Work, Use The Following Additional Language: We have previously planned our audit, and have conducted field work, without knowledge of your plans to share our audit report with [Additional User], for the purpose described above. In light of these changed circumstances, we feel compelled to reexamine our audit plans, and to determine whether additional procedures should be pursued so that our audit is properly designed and conducted under the circumstances. We may need to perform additional field work and request additional assistance from your staff. This may cause additional delay and/or expense.*

This letter is issued in connection with our audit report on the Company's 20XX financial statements. Our understanding and acknowledgement herein does not extend to future reports, if any, that might be rendered in connection with future engagements.

Very truly yours,

[Name & Title of CPA]

[Firm Name]

CC: [User Name]

**(Reply Letter To Client Rejecting New User's Right To Rely On Audit Report)**

[Date]

[Name]  
[Address]  
[City, State, Zip]

Dear [Name]:

It has come to our attention that [User Name] intends to rely upon our auditor's report on the financial statements of [Client] (the "Company") for the year ending [Date]. As explained in our engagement letter dated [Date] we did not intend that [User Name] or other undisclosed third parties use or rely on our auditor's report without our express written consent.

**By copy of this letter to [User Name] we are notifying [User Name] that we expressly reject [User Name]'s right to rely upon our auditor's report and disclaim any and all liability arising from [User Name]'s unauthorized use and reliance on that report.**

We performed our audit for your use, and at no time before or during the audit did you or [User Name] communicate to us [User Name]'s intent to rely. Indeed we are unaware of any contemplated transaction of the nature which involved [User Name].

We issued an opinion on your financial statements, based upon an audit which we conducted, the object of which was to determine whether your financial statements presented fairly, in all material respects, the Company's financial position in conformity with generally accepted accounting principles.

Under generally accepted auditing standards, we designed our auditing procedures to provide us with reasonable assurance that we would detect errors or irregularities, if any, that would have a material effect upon the financial statements. However, our audit was not a complete examination of every entry of the financial books of the Company. Rather, it involved selective testing. This necessarily involves judgment as to the number of transactions to be audited, the method of testing to be employed, and the acceptable tolerances of test results. Like all audits, our audit was subject to the risk that material or immaterial errors or irregularities, if they exist, may not have been detected. At the conclusion of our audit we issued our opinion as to whether the Company's financial statements fairly present, in all material respects, the financial position of the Company. This opinion should not be taken as a guaranty of the Company's financial position. Our opinion reflects our considered judgment.

Because the design and conduct of the audit involves professional judgment, it is possible that others might assess various matters differently. This is particularly true when the user of a financial statement is especially concerned with components of the financial statement important to a particular transaction, rather than the financial statements as a whole.

Accordingly, items of possible interest to [User Name] may not be specifically addressed. [User Name] should not rely upon our audit report. We expect that [User Name] has conducted its own due diligence investigation of the Company and will continue to do so in the future, including an analysis of the Company's current business activities, discussions with the Company's management, consideration of non-financial and external factors which may impact upon the Company and such other procedures as you may deem appropriate.

We wish to emphasize that management of the Company has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for safeguarding assets and for devising a system of internal control that will, among other things, help assure the preparation of proper financial statements. The financial statements are the representations of management. In forming our opinion on the Company's financial statements, we have relied upon such management representations which, in our professional judgment, appropriately merit our reliance.

#### **Additional Language When Reliance Letter Relates to Dated Financial Reports**

It should be noted that the financial statements to which our report relates are now \_\_\_\_\_ months old. [User Name], in exercising due diligence, in addition to obtaining whatever information may be necessary for its purposes, should consider obtaining more current financial statements of the Company. The untimeliness of the financial statements to which our audit report relates provides yet another reason why [User Name] should **not** rely upon our audit report in connection with the proposed transaction.

Very truly yours,

[Name & Title of CPA]

[Firm Name]

CC: [User Name]

**(Reply Letter To Client Acknowledging New User’s Intent To Rely on Review Report)**

[Date]

[Name]

[Address]

[City, State, Zip]

Dear [Name]:

As indicated in our engagement letter to you of [Date], our firm has been engaged to review, in accordance with standards established by the American Institute of Certified Public Accountants, the financial statements of [Client] (the “Company”) as of and for the year ended [Date].

We understand and acknowledge:

- (a) that the Company plans to provide [User Name] with a copy of the reviewed 20XX financial statements and our report thereon;
- (b) that the [User Name] intends to rely upon our report in connection with the following transaction: [Describe Transaction in Detail]; and
- (c) that you intend for [User Name] to so rely.

As we explained in our engagement letter, our review [will be/was] conducted in accordance with standards established by the American Institute of Certified Public Accountants, the objective of which [is/was] to provide us, through the performance of inquiry and analytical procedures, with a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. A review consists principally of inquiries of the company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit 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. Accordingly, we [will not express/have not expressed] such an opinion. As a matter of fact, an opinion is disclaimed.

Our review of the Company’s 20XX financial statements [will be/was] made for the purpose stated above. Therefore, it is likely that items of possible interest to the [User Name] [will/were] not be specifically addressed. Accordingly, our review should not be taken to supplant the inquiries and procedures that [User Name] should undertake for the purpose of satisfying itself as to the Company’s credit worthiness or as to the advisability of entering into the transaction described above.

We previously furnished you a copy of our communication entitled “What We Do.” You agreed to send a copy of that communication to each user who is furnished with a copy of our review report. We understand that you [will do/have done] so. If we are incorrect, please advise us as soon as possible.

We also wish to emphasize that management of the Company has the responsibility to adopt sound accounting policies, to maintain an adequate and effective system of accounts, for safeguarding assets and for devising a system of internal control that will, among other things, help assure the preparation of proper financial statements. The financial statements are the representations of management. In conducting our review, [we intend to rely/have relied] on such management representations which, in our professional judgment, merit our reliance.

#### **Additional Language When Notice Of Reliance Received After Issuance Of Review Report**

Our review report on the Company’s 20XX financial statements, dated [Insert Date], indicated that we were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles. We have performed no procedures with respect to those financial statements subsequent to that date, nor have we reviewed any financial statements of the Company subsequent to [Insert Date]. Therefore, no assurance can be given that other possibly significant matters did not arise thereafter.

#### **Additional Language When Reliance Letter Relates To Dated Financial Statements**

It should be noted that the financial statements to which our review report relates are now \_\_\_\_\_ months old. [User Name], in exercising its due diligence, in addition to obtaining whatever information may be necessary for its purposes, should consider the need to request and obtain more current financial statements of the Company.

This letter is issued in connection with our report on the Company’s 20XX financial statements. Our understanding and acknowledgement does not extend to future reports, if any, that might be rendered in connection with future engagements.

Very truly yours,

[Name & Title of CPA]

[Firm Name]

CC: [User Name]

**(Reply Letter To Client Rejecting New User’s Reliance on Compilation Report)**

[Date]

[Name]  
[Address]  
[City, State, Zip]

Dear [Name]:

It has come to our attention that [User Name] intends to rely upon the financial statements of the [Client] (the “Company”) on which we issued a compilation report dated [Insert Date]. As we explained in our engagement letter dated [Date], we did not intend that any undisclosed third parties, including [User Name], would rely on our compilation report without our express written consent.

A compilation is limited to presenting in the form of financial statements information that is the representation of management. We did not audit or review the Company’s financial statements, and accordingly, did not express an opinion or any other form of assurance on them. Consequently, [User Name] **cannot** rely on our report.

**By copy of this letter to [User Name] we are notifying [User Name] that we expressly reject [User Name]’s right to rely on our compilation report and disclaim any and all liability arising from any unauthorized reliance on that report.**

Very truly yours,

[Name & Title of CPA]  
[Firm Name]

CC: [User Name]

**Letter of Agreement With Third Party To Use Financial Statements and Audit  
Workpapers**

[Date]

[Third Party]  
[Street]  
[City, State ZIP]

Dear Sirs:

Under the terms of our audit engagement letters to [Client Name] (the “Company”) this accounting firm (hereafter referenced as “We, Us or Our”) has been engaged to audit, in accordance with generally accepted auditing standards, the financial statements of the Company as of [end of audit year].

We understand and acknowledge:

- (a) the Company plans to provide [Third Party Name] (“You”) a copy of the audited financial statements for the period described above, and our report in which our opinion is expressed; and
- (b) that You intend to use in some fashion both our audit report and the financial statements to which our audit reports relate, as well as such portions of our audit workpapers that pertain to the audit reports in connection with the following transaction: [Insert Details of Transaction] (hereafter the “Transaction”); and
- (c) that you seek our consent to your use of our workpapers and report in connection with your “due diligence” work in connection with the above-described Transaction.

We wish to remind you that the Company has engaged us to render an opinion on the Company’s financial statements for the above-described period. So that we can render an opinion, we have conducted audit procedures in accordance with generally accepted auditing standards. Our object is to determine whether the Company’s financial statements present fairly, in all material respects, the Company’s financial position in conformity with generally accepted accounting principles.

Under generally accepted auditing standards, we have the responsibility to design our auditing procedures to provide us with reasonable assurance that we will detect errors or irregularities that would have a material effect upon the financial statements. We also have the responsibility to conduct the auditing procedures with due care. Under those standards, we have the responsibility, within the inherent limitations of the auditing process, to plan and perform our audit to obtain **reasonable assurance** about whether the financial statements are free of material misstatement, whether caused by error or fraud, and to exercise due care in the conduct of our audit. The concept of selective testing of the data being audited, which involves judgment regarding both the areas to be tested and the nature, timing, and extent of the tests to be performed, has been generally accepted as a valid and sufficient basis for an auditor to express an opinion on financial statements.

Our audit is not a complete examination of every entry in the financial books of the Company. Rather, it involves selective testing. This necessarily involves judgment as to the number of transactions to be audited, the method of testing to be employed, and the acceptable



tolerances of test results. All audits are subject to the risk that material errors or irregularities, if they exist, may not be detected. At the conclusion of the current audit, as has been the case with the 2009 audit and the 2010 audit we expect to issue an *opinion* as to whether the Company's financial statements fairly present, in all material respects, the financial position of the Company. This opinion should not be taken as a guaranty of the Company's financial position. The numbers on the financial statement are not certified to be exact, but may contain estimates. Our opinion reflects our considered judgment.

Thus, our audit, based on the concept of selective testing, is subject to the inherent risk that material errors or fraud, if they exist, will not be detected. In addition, an audit does not address the possibility that material errors or fraud may occur in the future.

Because the design and conduct of the audit involves professional judgment, it is possible that others may assess various matters differently. This is particularly true when the user of a financial statement is especially concerned with components of the financial statement important to a particular transaction, rather than the financial statements as a whole. Among other things, we have not expressed an opinion or other form of assurance on individual account balances, financial amounts, or financial information. We have not designed or conducted any audit to consider Your interests or areas potentially of concern to You.

Accordingly, items of possible interest to You may not have been specifically addressed. Our audits were neither planned nor conducted for Your benefit and should not be taken to supplant or in any way replace the inquiries and procedures that You should undertake for the purpose of satisfying Yourself as to the Company's value, business potential, credit worthiness or for other purposes associated with the above-described transaction. We are making available to You excerpts of our workpapers for historical purposes only; i.e., so that you may see the procedures that we undertook in the performance of our audits. For that purpose only, we will provide You access to our reports and workpapers.

We expect that You will conduct Your due diligence investigation of the Company and will continue to do so in the future, including an analysis of the Company's financial position as you may decide best to verify for your purposes, current business activities, discussions with company management, consideration of non-financial and external factors which may impact upon the Company, and such other procedures as You may deem appropriate, especially if you intend to utilize a valuation method that places heavy reliance on one or more components of Client's Financial Statements.

We wish to emphasize that management of the Company has the responsibility for adopting sound accounting policies, for maintaining an adequate and effective system of accounts, for safeguarding assets and for devising a system of internal control that will, among other things, help assure the preparation of proper financial statements. The financial statements are the representations of management. In forming our opinion on the Company's financial statements, we have relied on such management representations, which, in our professional judgment, appropriately merit our reliance. You may elect to verify more or different management representations to take into account such matters as may be important to you.

Concerning the most recent audit, we have previously planned our audit, and have conducted field work, without knowledge of your plans to share our audit report with You. You need to understand that the audit is not planned or exercised in contemplation of being utilized as a tool in connection with Your "due diligence" activities. If you seek to rely on audit procedures as part of those "due diligence" activities, we suggest that you engage your own independent auditor to conduct an audit designed for your purposes. It is expressly understood that we assume

no additional responsibility to You with respect to our audit of the Company's financial statements.

Because Your examination of our workpapers and audit reports is undertaken solely for the purpose described above, and will not entail a review of all of our workpapers, You agree that (a) the information You obtain will not be used for any other purpose, (b) You will not comment orally or in writing, to anyone as a result of Your examination as to whether our audit was performed in accordance with auditing standards generally accepted in the United States of America and (c) You will not provide expert testimony or litigation support services or otherwise accept an engagement to comment on issues relating to the quality of our audit. You further agree that you will require any independent accounting firm that You may engage for the purpose of assisting you with "due diligence" to similarly agree with these terms and specifically agree not to be engaged to render its opinion on any financial statements of the Company, and not to use the audit procedures and judgments documented in our workpapers as audit evidence in any way.

We undertake no responsibility and make no commitment to provide You with copies of our workpapers, electronic or otherwise. Any agreement that we may reach to provide you with selective copies shall not be used or construed in any way as constituting application by copies of other workpapers or documents that we may elect to keep confidential, or to which we may provide access by inspection only.

Furthermore, in the event of a third-party request for access to any portion of our workpapers or reports which we provide to You under the terms of this letter, You agree to obtain our permission before voluntarily allowing any such access to our workpapers or reports, and to obtain on our behalf any releases from such third party that are consistent with the terms of this letter. You also agrees to advise us promptly of and, in any event, in advance of compliance with, any request by subpoena, summons, or court order for access to copies of our workpapers or reports.

In consideration of our agreement to provide access to the workpapers and reports referenced above, You agree that You do not acquire any rights as a result of such access, and acknowledge that we do not assume any duties or obligations in connection with such access.

To the fullest extent allowed by law, You agree to indemnify us and hold us harmless from any claim by You or any other third party, other than the Company, to the extent that such claim arises as a result of our permitting access to our workpapers and reports in connection with this transaction, from any and all liabilities, costs or expenses of any nature whatsoever, including legal fees incurred by us in defending ourselves.

Further, except as required by law, that the information acquired as a result of re-examination of our work papers and reports as contemplated by this letter by You and others acting on Your behalf will be used only in connection with Your evaluation of the transaction described above and that You will show this letter to, and secure the commitment to the provisions of this letter by all parties acting on Your behalf.

Further you agree that any dispute arising out of or under the terms of this letter shall be resolved by final and binding arbitration under the Rules of the American Arbitration Association pertaining to disputes with accounting firms in effect at the time of the dispute. Any such arbitration shall take place in [City, State]. The provisions of the Federal Arbitration Act shall apply to such arbitration, and, otherwise, internal law of the State of \_\_\_\_\_ shall apply, without regard to conflicts of law provisions. The audit interference rule shall not apply, and the Company, and not Us, shall be responsible for any

misrepresentations of management or any material misstatements of financial position that may appear in the Company's books and records or financial statements. The arbitrator shall have the authority to award compensatory damages only, and in no event shall the arbitrator have the authority to enter an award against the auditors or the audit firm for an amount that exceeds the amount paid to us for the audit or audits from which such damages may arise. In no event shall we be liable for any failure of management to perform properly any management function, to make adequate or accurate disclosures, to maintain an effective system of internal control or for any failure to detect any illegal, irregular, fraudulent, or otherwise inappropriate act. In no event shall we be liable for any damages calculated in whole or in part by capitalizing reported or expected earnings.

Your signature below signifies you fully agree with the terms contained herein, and that you agree that we may rely upon your assent in determining the extent to which we provide access to workpapers and reports described in this letter.

Dated this    day of \_\_\_\_\_, 20    .

Very truly yours,  
[Audit Firm]  
By:

AGREED:

[THIRD PARTY]  
By:

## **APPENDIX J**

### **Sample Limited Liability And Indemnification Language For Use In Engagement Letters**

The following is sample alternative limited liability and indemnification language you might consider when drafting your engagement letters. However, you should keep in mind that limited liability and indemnification language is not appropriate for all engagements. For example, the SEC forbids the use of such clauses in engagement letters with public companies. Further, even where limited liability and indemnification language may be acceptable, the permissible scope of such clauses may be limited by jurisdictional or professional regulations of the client or the accountant. Therefore, **you should consult with your firm's legal counsel in your state to determine which, if any, of the following language is appropriate for your particular engagement.**

#### **Sample Limited Liability Language for Engagement Letters.**

***Damages Limited to Lesser of Actual Damages for Fees Paid*** By signing this Engagement Letter, you agree that our liability arising from this engagement shall be limited to the lesser of any actual damages which may have been caused by our acts or omissions, or the amount of the fees which you pay for our services.

***Damages Limited to Liquidated Damages Only*** By signing this Engagement Letter, you agree that our liability arising from this engagement shall be limited to no more than \_\_\_\_\_% of the fees which you pay us for the performance of this engagement.

***Hold Harmless for Damages Resulting from Management's Knowing Misrepresentations*** By signing this engagement letter, you agree to release, indemnify, defend and hold us harmless from any liability or costs, including attorneys' fees, resulting from management's knowing misrepresentations.

***Limit Damages by Referral to Arbitration*** By signing this Engagement Letter, you agree to submit any dispute concerning our services to final and binding arbitration conducted under the Rules of the American Arbitration Association which pertain to the resolution of claims against accountants. The arbitrator(s) shall have the authority to award compensatory damages, but only for such damages found to have been directly and solely caused by acts, errors, or omission committed in violation of our professional duties. The arbitrator (or one of the arbitrators) shall be a certified public accountant with at least years of experience in public accountancy.

## **Indemnity for Defense Costs in Engagement Letters.**

***“Loser Pays” Agreement*** Should suit be brought concerning the quality or timeliness of our performance of services in this engagement, it is agreed that the party who prevails shall be entitled to recover its attorneys’ fees. If plaintiff is awarded judgment greater than the largest offer of settlement made within days after the service of suit, plaintiff shall be deemed to have prevailed. Otherwise, defendant shall be deemed to have prevailed.

***Agreement to Pay Defense Costs — Breach of Agreement Not to Sue*** By signing and returning a copy of this Engagement Letter, the undersigned client agrees that any issue concerning the quality or timeliness of the work in this engagement shall not form the basis for legal action, and agrees not to bring suit. Should suit be brought in violation of this agreement, the undersigned client agrees to pay the legal fees incurred in the defense of such action.

***Agreement to Pay Defense Legal Costs — No Prohibition Against Suit*** In addition to the fees for services described in this Engagement Letter, the undersigned client agrees to pay an amount equal to any and all legal fees incurred by this firm in connection with this engagement, including (by way of illustration and not limitation) legal fees incurred for advice on any issue relating to this engagement; incurred in connection with any suit to recover the fees due for this engagement; incurred by this firm in responding to any subpoenas or other legal process relating to this engagement; and incurred in the defense of any action brought against this firm.

## **APPENDIX K**

### **Sample Individual 1040 Engagement Letter**

John A. Client  
Street  
City, ST Zip

Dear Mr. Client:

This letter is to confirm and specify the terms of our engagement with you and to clarify the nature and extent of the services we will provide. In order to ensure an understanding of our mutual responsibilities, we ask all clients for whom returns are prepared to confirm the following arrangements.

We will prepare your federal and requested state individual income tax returns for calendar year 2016. We are under no duty to review the information you provide to determine whether you may have a filing obligation with another state. If we become aware of any other filing requirement, we will tell you of the obligation and may prepare the appropriate returns at your request as a separate engagement.

This engagement letter does not cover the preparation of any financial statements, which, if we are to provide, will be covered under a separate engagement letter.

It is your responsibility to provide all the information required for the preparation of complete and accurate returns. You should retain all the documents, canceled checks, and other data that form the basis of income and deductions. These may be necessary to prove the accuracy and completeness of the returns to a taxing authority. You have the final responsibility for the income tax returns and, therefore, you should review them carefully before you sign them.

Your return may be electronically filed with the Internal Revenue Service Center and one or more state authorities through a secured third-party filing service. Electronic filing of your return does not affect your responsibility to review and approve the return before it is submitted. It is your responsibility to timely provide the signed e-file authorization form to us in order for us to timely e-file your return.

We may furnish you with questionnaires and/or worksheets to guide you in gathering the necessary information. Your use of such forms will assist in keeping the fee to a minimum. You represent that the information you are supplying to us is accurate and complete to the best of your knowledge and that you have disclosed to us all relevant facts affecting the returns. We will not verify the information you give us; however, we may ask for additional clarification of some information.

Each U.S. person who has a financial interest in or signature or other authority over foreign bank accounts, securities accounts or other financial accounts must file a Form 114 for each calendar year during any part of which the aggregate value of the accounts exceeds \$10,000. This is true even if the account has not earned any income during the year. You may also be required to file Form 8938 to report ownership of specified foreign financial assets if the total value of those assets exceeds an applicable threshold amount. It

is your responsibility to provide us with this information.

You should also know that IRS audit procedures will almost always include questions on bartering transactions and on deductions that require strict documentation such as travel and entertainment expenses and expenses for business usage of autos and computers. In preparing your returns, we rely on your representations that we have been informed of all bartering transactions and that you understand and have complied with the documentation requirements for your expenses and deductions. If you have questions about these issues, please contact us.

Our work in connection with the preparation of tax return(s) does not include any procedures designed to discover defalcations or other irregularities, should any exist. The returns will be prepared solely from information provided to us without verification by us. We will render such accounting and bookkeeping assistance as determined to be necessary for preparation of the income tax returns.

In accordance with federal law, in no case will we disclose your tax return information to any location outside the United States, to another tax return preparer outside of our firm for purposes of a second opinion, or to any other third party for any purpose other than to prepare your return without first receiving your consent.

The IRS permits you to authorize us to discuss, on a limited basis, aspects of your return for one year after the return's due date. Your consent to such a discussion is evidenced by checking a box on the return. Unless you tell us otherwise, we will check that box authorizing the IRS to discuss your return with us.

It is our policy to keep tax returns for seven years. However, we do not keep any of your original records, so we will return those to you upon the completion of the engagement. When records are returned to you, it is your responsibility to retain and protect the records for possible future use, including potential examination by governmental or regulatory agencies.

By signing this engagement letter, you acknowledge and agree that upon the expiration of the 7<sup>th</sup> year, we are free to destroy our records related to this engagement.

The return(s) may be selected for review by the taxing authorities. In the event of an audit, you may be requested to produce documents, records, or other evidence to substantiate the items of income and deduction shown on a tax return. Any proposed adjustments by the examining agent are subject to certain rights of appeal. In the event of a tax examination, we will be available, upon request, to represent you. However, such additional services are not included in the fees for the preparation of the tax return(s).

Federal income tax law specifically requires that any deduction for travel and entertainment expense must be substantiated by records indicating the amount, time, place and business purpose of the expenditure, and for entertainment expenditures of \$75 or more. If you claim deductions for entertainment and/or travel expenses, you represent to us that you have the required records and receipts. If you claim a deduction for business use of an automobile, computer or other asset used partly for personal use, you are required to substantiate such deductions by adequate records of sufficient corroborating evidence.

Such evidence need not be in writing, although written evidence will have greater value. In the case of a vehicle, you are required to indicate on the income tax return, for each vehicle, the total mileage driven for business use, commuting and other personal use, percentage of business use, date placed in service, whether you have evidence to support the business use claimed, and whether or not the evidence is written.

In the case of a computer or other asset used partly for personal purposes, similar questions (except for those relating to mileage) must be answered on your income tax return.

- ( ) I WILL claim deductions for business use of vehicle(s) on my 2017 income tax returns, and have completed and enclosed the attached Exhibit A.
- ( ) I WILL NOT claim deductions for business use of vehicle(s) on my 2017 income tax returns.
- ( ) I WILL claim deductions for these expenses on my 2017 tax returns, and have read and signed Exhibit B.
- ( ) I WILL NOT claim deductions for these expenses on my 2017 income tax returns.

If the income tax returns we are to prepare in connection with this engagement are joint returns, and because you will each sign those returns, you are each our client. You each acknowledge that there is no expectation of privacy from the other concerning our services in connection with this engagement, and we are at liberty to share with either of you, without the prior consent of the other, any and all documents and other information concerning preparation of your returns. We will require, however, that any request for documents or other information be communicated to us in written form. You also acknowledge that unless we are notified otherwise in advance and in writing, we may construe an instruction from either of you to be an instruction on your joint behalf. Absent a contrary written instruction in the future, from either or both of you, we will communicate with either or both of you at your current mailing address.

We will use professional judgment in resolving questions where the tax law is unclear, or where there may be conflicts between the taxing authorities' interpretations of the law and other supportable positions. Unless otherwise instructed by you, we will resolve such questions in your favor whenever possible.

The law provides various penalties and interest that may be imposed when taxpayers underestimate their tax liability. You acknowledge that any such understated tax, and any imposed interest and penalties, are your responsibility, and that we have no responsibility in that regard.

We have the right to withdraw from this engagement, in our discretion, if you don't provide us with any information we request in a timely manner, refuse to cooperate with our reasonable requests or misrepresent any facts. Our withdrawal will release us from any obligation to complete your return and will constitute completion of our engagement. You agree to compensate us for our time and out-of-pocket expenses through the date of our withdrawal.



If an extension of the time to file is required, any tax due with these returns must be paid with that extension. Any amounts not paid by the filing deadline may be subject to interest and late payment penalties.

Notwithstanding anything contained herein, both CPA FIRM, P.C. and you agree that regardless of where you are domiciled and regardless of where this agreement is physically signed, this agreement shall have been deemed to have been entered into at CPA FIRM, P.C.'s office located in Your County, Your State, U.S. and Your County, Your State, U.S. shall be the exclusive jurisdiction for resolving disputes related to this agreement. This agreement shall be interpreted and governed in accordance with the laws of Michigan.

In the event we are required to respond to a subpoena, court order or other legal process for the production of documents and/or testimony relative to information we obtained and/or prepared during the course of this engagement, you agree to compensate us at our hourly rates, as set forth below, for the time we expend in connection with such response, and to reimburse us for all of our out-of-pocket costs incurred in that regard.

In the event that we become obligated to pay any judgment or similar award, agree to pay any amount in settlement, and/or incur any costs as a result of any inaccurate or incomplete information that you provide to us during the course of this engagement, you agree to indemnify us, defend us, and hold us harmless as against such obligations, agreements, and/or costs.

Generally, our fee for these services will be based upon the amount of time we spend on your return plus out-of-pocket expenses. Payment is expected 15 days after you have received your invoice. If we ever have to collect on any unpaid balance, you agree to pay all our costs of collection including all attorney fees.

You acknowledge and agree that all accounting work provided by us to you, pursuant to this engagement letter or otherwise, is intended to be relied upon solely by you and by no one else.

If the foregoing fairly sets forth your understanding, please sign this letter in the space indicated and return it to our office. The enclosed copy stamped "Client Copy" is for your files. However, if there are other tax returns you expect us to prepare, such as gift and/or property, please inform us by noting so on the return copy of this letter.

If this firm does not receive from you the original of this letter, in fully executed form, but receives from you supporting documentation to prepare your return; then, such receipt by this office shall be deemed to be evidence of your acceptance of all of the terms set forth above.

We want to express our appreciation for this opportunity to work with you.

Very truly yours,

AGREED TO AND ACCEPTED:

By: \_\_\_\_\_  
(Taxpayer)

By: \_\_\_\_\_  
(Spouse)

Date: \_\_\_\_\_

Date: \_\_\_\_\_

**EXHIBIT A**

**BUSINESS VEHICLE USAGE DATA**

The following questions, which appear in the individual return, relate to usage of your vehicle(s), and require a response for the year ending December 31, 2016:

	<u>Veh. # 1</u>	<u>Veh. # 2</u>	<u>Veh. # 3</u>	<u>Veh. # 4</u>
<b>Description of Vehicle</b>				
Model	_____	_____	_____	_____
Date purchased	_____	_____	_____	_____
Cost	_____	_____	_____	_____
1. Business miles:	_____	_____	_____	_____
Commuting miles:	_____	_____	_____	_____
Other personal miles:	_____	_____	_____	_____
Total miles driven:	_____	_____	_____	_____
Daily round trip commuting distance:	_____	_____	_____	_____
<b>Actual Expenses</b>				
Parking fees & tolls	_____	_____	_____	_____
Gasoline, oil, repairs, insurance, etc.	_____	_____	_____	_____
Interest, registration & taxes	_____	_____	_____	_____
Vehicle rentals	_____	_____	_____	_____
2. Do you have another vehicle available for personal use?	__Y__N	__Y__N	__Y__N	__Y__N
3. Do you have evidence to support the mileage breakdown provided above?	__Y__N	__Y__N	__Y__N	__Y__N
4. Is the evidence written?	__Y__N	__Y__N	__Y__N	__Y__N

\_\_\_\_\_  
TAXPAYER

\_\_\_\_\_  
DATE

**EXHIBIT B**

CPA FIRM, P.C.  
Street Address  
City, ST ZIP

Gentlemen:

The purpose of this letter is to represent to you that I am aware of the following:

A taxpayer may be able to deduct entertainment expenses incurred in the performance of his duties as an employee. The tax treatment depends on the arrangement they have with their employer. In particular, it depends on whether they are reimbursed for their costs and, if so, under what type of arrangement. Such expenses may be deducted only as miscellaneous itemized deductions subject to a two-percent floor.

In order to be deductible, entertainment expenses must be ordinary and necessary expenses incurred by a taxpayer in carrying on a trade or business. In addition, the expenses must be:

1. directly related to the active conduct of a trade or business,
2. associated with the active conduct of a trade of business, or
3. covered by one of the exceptions to the entertainment expenses.

In addition, the expenses must be adequately substantiated as follows:

**AMOUNT:** Receipts are required for expenses over \$75, and meal and entertainment expenses should be separated from related incidental expenses, such as taxi, telephone, etc.; estimation of amount based on probable evidence is unacceptable.

**TIME:** Date of business meal or entertainment, plus time spent on bona fide business discussion.

**PLACE:** Name and address of activity; nature of entertainment, if not otherwise apparent; location of business discussion, if different.

**PEOPLE:** Name, position and employer of individuals in attendance plus other data if needed to show business relationship to taxpayer; identity of the person representing the taxpayer at a business meal.

**PURPOSE:** Nature of business discussion and business benefit gained or expected to be gained from discussion.

The amount allowable as a deduction for business meal and entertainment expenses is limited to 50 percent of such expenses. For purposes of this rule, food and beverage cost incurred in the course of travel away from home is included. With respect to unreimbursed meal expenses incurred while traveling away from home, the two-percent floor on miscellaneous itemized deductions is applied after the 50-percent limitation. That portion of a travel meal that is "Lavish and Extravagant" must first be subtracted from the meal cost before the 50-percent limitation is applied.

I represent to you that I understand and maintain the records necessary to substantiate the deductions for entertainment and meals.

NAME \_\_\_\_\_ DATE \_\_\_\_\_

NAME \_\_\_\_\_ DATE \_\_\_\_\_

## **DISCLAIMER**

**The sample documents above are provided for general information purposes only. Your use of any of these sample documents is at your own risk, and you should not use any of these sample documents without first seeking legal and other professional advice. The provision of these sample documents (and the documents themselves) do not constitute legal advice or opinions of any kind. No lawyer-client, advisory, fiduciary or other relationship is created between CPA Mutual Insurance Company of America, RRG (CPAM) and any person accessing or otherwise using any of the sample documents. CPAM and its affiliates (and any of their respective directors, officers, and employees) will not be liable for any damages, losses or causes of action of any nature arising from any use of any of the sample documents or the provision of these sample documents or reliance on any of the information contained herein.**