PROSPECTIVE FINANCIAL STATEMENTS: GUIDELINES FOR A GROWING PRACTICE AREA

How a new AICPA ED would be applied in practice.

by Don Pallais and Robert K. Elliott*

A client wants help in estimating his personal income taxes for next year. Another client wants help in order to decide whether to lease or buy a new machine. A condominium association needs assistance in developing a budget. A promoter needs help in putting together an offering to sell a real estate limited partnership to a group of doctors.

What do these engagements have in common? Each one may involve prospective financial statements, the subject of a new American Institute of CPAs Exposure Draft (ED), *Proposed Guide for Prospective Financial Statements.*[1]

The ED proposes guidelines for the services accountants may provide concerning prospective financial statements. It is an ambitious document in that, to accomplish this, it would affect all of the traditional disciplines of the profession—not only auditors and accountants but also management advisory services and tax practitioners. The ED probably would affect more types of practitioners performing more types of services than any other technical pronouncement.

This article describes the ED, explains the rationale behind it and shows how the ED would be applied in practice. Readers should keep in mind, however, that the document is an exposure draft and, therefore, is subject to change. Until a final guide is published, practitioners should consult for guidance the *Guide for a Review of a Financial Forecast*,[2] Statement of Position (SOP) no. 75-4, *Presentation and Disclosure of Financial Forecasts*,[3] the AICPA auditing standards division SOP entitled *Report on a Financial Feasibility Study*[4] and Rule 201(e)—General Standards (Forecasts) of the Code of Professional Ethics and related interpretation.

Types of Prospective Financial Statements Covered by the ED

Prospective financial statements, as defined in the ED, are presentations of future-oriented financial information that contain, at a minimum, certain items (see exhibit 1, page 58). Presentations that omit one or more of these items are called "partial presentations" and are not covered by the ED. The ED also doesn't apply to pro forma presentations (which are essentially historical financial statements adjusted for a prospective transaction) nor does it apply to prospective financial statements covering wholly expired periods (for example, last year's budget wouldn't be covered by the ED because the information is no longer prospective; but this year's budget would be covered if any unexpired portion of the year remains).

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[1] AICPA Exposure Draft, *Proposed Guide for Prospective Financial Statements* (New York: AICPA, September 20, 1983).

[2] Financial Forecasts and Projections Task Force, *Guide for a Review of a Financial Forecast* (New York: AICPA, 1980).

[3] Statement of Position no. 75-4, *Presentation and Disclosure of Financial Forecasts* (New York: AICPA, 1975).

[4] Auditing Standards Division SOP, *Report on a Financial Feasibility Study* (New York: AICPA, 1982).

The ED classifies prospective financial statements into three types: forecasts, projections and multiple projections. The types of presentations and what they are intended to present differ somewhat from both current literature and practice and thus require some explanation.

The *Guide for a Review of a Financial Forecast* defines a forecast as an estimate of the most probable financial position, results of operations and changes in financial position for one or more future periods. It defines a financial projection as an estimate of financial results that are not necessarily the most likely.[5]

In the nine years since these definitions were established, issuers of prospective financial statements have had increasing difficulty with them. They have become reluctant to characterize any estimate about the future as "most probable" (for example, they argue that it is not possible to estimate any rate of inflation as most probable). In addition some issuers' attorneys have been similarly reluctant to have their clients characterize these estimates as most probable. As a result, some companies whose objectives were to issue prospective financial statements depicting their best estimates of results have issued projections (where no assertions about probability are made) rather than issue forecasts.

The ED attempts to encourage entities to present their estimates of future results by revising the definition of forecast to eliminate the troublesome most-probable concept. The ED defines a forecast as a presentation that depicts, to the best of management's knowledge and belief, the entity's expected future financial position, results of operations and changes in financial position based on conditions management expects to exist and actions it expects to take. It defines a financial projection as a presentation that depicts, to the best of management's knowledge and belief, expected future financial position, results of operations and changes in financial position *given the occurrence of one or more hypothetical* (that is, not expected) *assumptions,* based on conditions it expects *would* exist and actions it *would* take if the hypothetical assumptions materialized.

Thus, as revised, a forecast would be management's best estimate of what it expects to happen and a projection would be a presentation intended to answer the question "What would happen if . . .?" This differentiation appears to be easier to understand and apply than one based on judgments about probability of future occurrence.

Based on the revised definitions, forecasts would be useful for any class of users and for any purpose because they depict what management thinks will happen; for example, they would be useful for general offerings of debt or equity, negotiations or internal analysis. Projections, on the other hand, because they would depict something management does not expect to happen, would only be useful for management or outsiders who are evaluating the same "what ifs" as management and with whom management can discuss the presentation and underlying assumptions.

[5]These definitions were first developed by the management advisory services executive committee in MAS Guideline Series no. 3, *Guidelines for Systems for the Preparation of Financial Forecasts* (New York: AICPA, 1975).

Thus, projections wouldn't be useful to a passive user, but only to users able to evaluate and challenge the hypothetical assumptions. Typically, the users of financial projections would be parties in negotiations with the issuer, such as banks, or the issuer itself.

In some cases, management wants to prepare a forecast but is unable to because it can't develop a single point estimate relating to one or more conditions or courses of action. For example, a real estate developer may not be able to provide a single point estimate of the occupancy rate of a new apartment building although he believes occupancy will be higher than 70 percent but lower than 90 percent. To address this situation, the ED provides for a third type of presentation: a multiple projection, which is a presentation of two or more projections (for example, results given hypothetical occupancy rates of, say 70 percent and 90 percent) when management has reason to expect that the actual results will fall within the range presented (that is, the actual occupancy rate is expected to be between 70 percent and 90 percent and, presumably, the results of operations and changes in financial position would also fall within the range of amounts presented).[6]

The ED proposes multiple projections as a practical solution for situations in which management wants to present a forecast but, for one reason or another, cannot. The ED doesn't propose to limit the size of the range presented in a multiple projection but, rather, relies on a combination of market and litigation considerations to provide the appropriate tolerance level. Management's instinct would ordinarily be to widen the range to make sure the actual result falls within it. However, because users would likely perceive wider ranges as signifying riskier ventures, they would charge more for use of capital—providing an incentive for management to narrow the range. These conflicting pressures are expected to result in reasonable ranges in multiple projections.

Thus multiple projections, like forecasts, would be presented to estimate future results and therefore would be useful for any users for making financial decisions.

Exhibit 1

***Proposed Guide for Prospective Financial Statements:* a summary of disclosure requirements**

Prospective financial statements should include, at a minimum, the following items (where they would be presented for historical financial statements) or their counterparts for presentations based on comprehensive bases of accounting other than generally accepted accounting principles:

- ☐ Sales or gross revenues.
- ☐ Gross profit.
- ☐ Unusual or infrequently occurring items.
- ☐ Provision for income taxes.
- ☐ Discontinued operations or extraordinary items.
- ☐ Net income.
- ☐ Primary and fully diluted earnings per share.
- ☐ Significant changes in financial position.
- ☐ Summary of significant assumptions and identification of which of those assumptions are particularly sensitive.

The presentation should also include disclosure of significant accounting policies. The accounting policies should be those expected to be used in the period under consideration, but in a projection different principles may be used. When the basis of accounting used is different than that used for historical financial statements (for example, when the cash basis is used for prospective financial statements and GAAP is used for historical financial statements) results calculated on the two bases should be reconciled.

Accountants' Association with Prospective Financial Statements

Accountants perform many kinds of services that involve prospective financial statements. They may, for example, provide financial or tax advice or they may assist their clients in negotiations for acquisitions or financing. Any of these engagements could give rise to accountants' association with prospective financial statements under the rules proposed by the ED.

Existing literature doesn't address when an accountant must report on prospective financial statements. The ED proposes a rule to require the accountant to report whenever he is associated with the statements. The definition of association would be based on con-

[6]The presentation of two or more projections in which the expected result does not fall within the range is not considered a multiple projection. It is merely two projections and its usefulness is as limited as that of a single projection.

cepts in Statement on Auditing Standards no. 26, *Association with Financial Statements*,[7] and Statement on Standards for Accounting and Review Services no. 1, *Compilation and Review of Financial Statements*,[8] and would read as follows:

"An accountant is associated . . . when he has consented to the use of his name in conjunction with the [prospective financial statements] in a report, document, or written communication containing [them]. Also, when an accountant submits to his client or others [prospective financial statements] that he has assembled[9] or assisted in assembling, he is deemed to be associated even though an accountant does not append his name to [them]. The accountant who is associated . . . should . . . report . . .; however, he is not deemed to be associated with [prospective financial statements] that, prior to the issuance of his report, [are] clearly identified as a draft."[10]

Thus, association with prospective financial statements would depend on two major factors: (1) whether the accountant's name was used in conjunction with the presentation or he or she assembled it or assisted in its assembly and (2) whether the service was provided on prospective financial statements.

To demonstrate the first factor: an accountant who uses microcomputer software to process client data to produce his client's budget would be associated with prospective financial statements because he assembled them. An accountant who makes software available to his client through time-sharing would not be associated with the statements because the client assembled them (unless his client used his name in conjunction with the statements in a document).

To demonstrate the second factor: the accountant's services with regard to partial presentations wouldn't be covered by the proposed association rule[11] because partial presentations wouldn't be prospective financial statements as defined in the ED. Similarly, the accountant who helps his client identify key factors or assumptions or who develops software for the client to do its own modeling would not, on that account, be associated with the resulting prospective financial statements because, although he provided a valuable service, the service didn't encompass the prospective financial statements. He would only be associated with them if, in addition to providing the software, he assembled, or assisted in assembling, the statements. (For example, if he not only provided the modeling software but also used it to produce prospective financial statements, he would be associated with the statements and would have to report on them.)

The accountant who is associated with the prospective financial statements would be required to report on them for the same reasons the accountant is required to report on historical financial statements. That is, users are better informed and the accountant is better protected if the accountant explicitly identifies the scope of his services and the degree of responsibility he is taking.

The ED states that the form of the accountant's report would depend on two factors: the potential users (third-party users or internal users) and the nature of service provided.

The primary objective of an accountant's involvement with prospective financial statements for use by third parties is similar to that of the accountant's services with respect to historical financial statements—to add credibility to those statements. Accordingly, the ED provides that, just as in the case of historical financial statements, the accountant's services and reports for prospective financial statements would be standardized when intended for third-party use. Standardization of services and reports would increase their usefulness to third-party users because the users would be able to easily identify and understand the services and reports.

The ED defines two levels of service on prospective financial statements for use by third parties. The services are reviews (originally defined in the *Guide for a Review of a Financial Forecast*), which would provide ex-

[7]Statement on Auditing Standards no. 26, *Association with Financial Statements* (New York: AICPA, 1979). See also *AICPA Professional Standards*, vol.1 (Chicago: Commerce Clearing House), AU section 504.

[8]Statement on Standards for Accounting and Review Services no. 1, *Compilation and Review of Financial Statements* (New York: AICPA, 1979). See also *AICPA Professional Standards*, vol. 2, AR sec. 100.

[9]The exposure draft defines *assembly* as the performance of mathematical or other clerical functions related to the presentation of the prospective financial statements. Assembly wouldn't refer to the mere reproduction and collation of such statements.

[10]AICPA ED, *Proposed Guide for Prospective Financial Statements*, sec. 500.01.

[11]However, the accountant should be aware of Rule 201(e)—General Standards (Forecasts) and related interpretation.

plicit assurance as to the presentation of the statements and the reasonableness of the assumptions; and compilations, which, similar to SSARS no. 1, would provide no explicit assurance on either the presentation or assumptions.

The objective of a service for internal-use-only prospective financial statements may be the same as for third-party-use statements, but probably more often it is not. Often, the objective of the service is to consult with the client, to give advice or to help the client make a decision. Thus, although the standard compilation and review services would be appropriate for internal-use-only prospective financial statements, the circumstances often call for a different form of service and a report that is responsive to the service rendered.

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To provide the flexibility required for engagements with varying objectives, the ED proposes a spectrum of services to be performed on internal-use-only prospective financial statements. At the low end of the spectrum would be mere assembly, the lowest level of service resulting in the accountant's association, while at the other end of the spectrum would be a review. In between would be numerous services, including not only compilation but also services not identified in the ED resulting in reports expressing various types of assurances as to the presentation of the statements and underlying assumptions.

The association rule would apply to services on internal-use-only statements as it does for statements intended for third-party use, so the accountant would have to report whenever he is associated with the statements. However, if the accountant is satisfied that the statements and reports are not going to outsiders he wouldn't need to use a standard report as long as the level of assurance expressed is supported by the work performed and his report clearly states that its distribution is limited to internal use.

The ED proposes that the accountant be required to report on internal-use-only statements even when distribution of the statements would be restricted to management because physical restrictions may not be effective and prospective financial statements may be improperly shown to outsiders. The accountant's report would provide him with some measure of protection against outsiders, who might incorrectly attribute too high a level of responsibility to him. It would also protect outsiders from misinterpreting the accountant's responsibility.

When the Accountant Should Not Be Associated with the Statements

The ED indicates that there would be instances in which the accountant shouldn't be associated with prospective financial statements. One of these is when prospective financial statements omit the summary of significant assumptions. This prohibition is based on the concern that prospective financial statements without assumptions won't be understandable and will result in useless or misleading presentations.

Certain microcomputer software can print out, in one form or other, the factors used in computing the prospective amounts. As long as this information is understandable to the user, it would ordinarily meet the ED's requirements. Obviously, some software does this more neatly than others and presumably accountants will keep this in mind in order to achieve a balance between the benefits of useful microcomputer printouts and the cost to search out or modify software to achieve this usefulness.

The ED would also prohibit an accountant from being associated with a financial projection (not a multiple projection) to be used in a general offering (unless it supplements a forecast or multiple projection) because, as previously mentioned, a financial projection wouldn't be useful to passive investors. To include a projection that doesn't supplement a forecast or multiple projection in a document going to such users would likely be misleading, and the accountant wouldn't ordinarily be associated with a presentation that could mislead outsiders.[12]

Reviews and Compilations

The review level of service was established in the *Guide for a Financial Forecast*. The ED

[12] In a review service the accountant might be associated with a misleading presentation but issue an adverse report.

doesn't propose any significant changes to this service except that it would extend the service to financial projections and multiple projections.

The ED identifies compilation as the lowest level of service an accountant could provide on prospective financial statements for outside use. The service would be similar to a SSARS no. 1 compilation—an informed reading of the statements, realizing that the accountant may have to help his client put amounts on paper. The procedures in the ED generally parallel those in SSARS no. 1 except where the nature of prospective data requires them to be different.

The procedures required for a compilation of prospective financial statements would primarily be

- ☐ Obtaining background knowledge.
- ☐ Assembling the statements.
- ☐ Reading the statements.
- ☐ Considering any actual results for an expired portion of the period.
- ☐ Attempting to correct any problems encountered.
- ☐ Obtaining signed representations.
- ☐ Reporting.

The accountant would be required to obtain knowledge of the client's industry and its accounting, just as he is under SSARS no. 1. Acquiring this knowledge about the entity and its industry gives the accountant a basis for considering the form of presentation and assumptions used.

Assembly of the prospective financial statements refers to the mathematical translation of management's expectations into prospective financial statements. If the client were to hand the accountant a complete financial forecast, this step wouldn't be necessary, just as in SSARS no. 1 the accountant (theoretically) need not put pencil to paper to compile financial statements. In the real world, however, clients often engage accountants primarily for this step. The ED contemplates that outside users relying on an accountant's compilation report probably would believe they have the right to expect the prospective financial statements to be mathematically accurate and so the ED would make assembly a distinct compilation procedure. (As stated earlier, an accountant who assembles prospective financial statements would be associated with those statements under the ED and would have to report on them.)

To be of value as a professional service, a compilation must imply certain things about which the accountant has special knowledge or expertise. Even though the compilation report would express no assurance, the public may be likely to assume that, in addition to being mathematically accurate, the compiled statements are based on acceptable accounting principles, presented in the proper form and not intended to mislead. Thus the ED proposes that the accountant be required to ask what accounting principles are used in the presentation (and compare these to his knowledge of the principles normally used) and where the assumptions came from (to consider whether management needs help in developing assumptions or whether it is unwise to be associated with the statements).

The accountant would then consider, based on this knowledge, whether the assumptions or the presentation are obviously inappropriate, incomplete or otherwise misleading. This consideration wouldn't require the type of analytical work done in a review (unless the accountant believed it necessary for his compilation) but, rather, can be considered a "smell test." If, based on his knowledge of the entity and of accounting and business in general, nothing strikes the accountant as obviously wrong with the presentation, he

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wouldn't need to perform any analytical procedures or further inquiries to complete his compilation.

When part of the prospective period has expired (for example, a 1983 budget done in March 1983) the ED proposes that the accountant be required to consider the historical results to date (that is, results for January and February 1983). The method and level of detail of this consideration would depend on the circumstances, but as the year goes on the historical results would tend to become more significant and the accountant would be more inclined to look at them closely. As an extreme case, a one year forecast done on the 364th day of the year would normally be expected to look very much like the historical results to date; if it did not, the accountant would be very concerned that the forecast was misleading.

In a significant departure from SSARS no. 1, the compiler of prospective financial statements would be required to obtain signed representations from management. Unlike historical financial statements, which are based on records of completed transactions, prospective financial statements are based on management's thoughts and expectations. Because the accountant can't see into management's mind the way he can look into a general ledger, the signed representations are his assurance that the statements are based on the appropriate assumptions and that management accepts responsibility for the assumptions. The ED specifies certain representations that the accountant would be required to obtain in writing and provides illustrative representation letters to show one way of obtaining them.

The ED proposes that the accountant be required to issue a standard report at the completion of the compilation engagement (unless the statements were for internal use only). The standard compilation report would give no assurance as to presentation or the assumptions and would be similar to a SSARS no. 1 compilation report. (The report on prospective financial statements, however, would carry warnings and descriptions relating to the fact that the statements depict the results of events that have not occurred and therefore may not come true.)

"The ED recognizes that the objective of an engagement done for internal use is often different than for engagements contemplating third-party reliance."

The standard compilation report would read as follows (in this example, a forecast was compiled):

"The accompanying forecasted balance sheet, statements of income, retained earnings, and changes in financial position and summaries of significant assumptions and accounting policies of XYZ Company as of December 31, 19XX, and for the year then ending, present, to the best of management's knowledge and belief, the Company's expected financial position, results of operations, and changes in financial position for the forecast period. Accordingly, the financial forecast reflects its judgment, based on present circumstances, of the expected conditions and its expected course of action. However, some assumptions inevitably will not materialize and unanticipated events and circumstances may occur; therefore, the actual results achieved during the forecast period will vary from the forecast and the variations may be material.

"We have compiled the forecast in accordance with applicable guidelines established by the American Institute of Certified Public Accountants. A compilation of a forecast does not include evaluation of the support for the assumptions underlying the forecast. Because a compilation of a forecast is limited as described above, we do not express a conclusion or any other form of assurance on the accompanying statements or assumptions. We have no responsibility to update this report for events and circumstances occurring after the date of this report."[13]

When the accountant encounters a problem with the assumptions, his first step would be to get the matter corrected (assuming it's material). If management was unwilling to revise the assumptions (or was unable to justify them), the ED proposes that the accountant be required to withdraw from the engagement. The ED specifies this action rather than disclosing the problem in the accountant's report for two reasons: (1) modifying the report for one assumption might imply some unintended level of assurance regarding the other assumptions and (2) the assumptions are often dependent on each other and users might not be able to understand the effect of a qualification on the presentation taken as a whole. Since the accountant often works closely with management when compiling statements, it isn't anticipated that it would be difficult for him to have misleading assumptions corrected. Therefore, it is expected that accountants would rarely have to withdraw from compilation engagements.

When prospective financial statements omit certain disclosures—other than those relating to assumptions—the accountant would describe the omission in his report. For exam-

[13]AICPA ED, *Proposed Guide for Prospective Financial Statements*, sec. 620.04.

ple, if the presentation omits disclosure of the accounting policies (see exhibit 1), the accountant would describe the omission in his report but would not normally be required to withdraw from the engagement, limit distribution of his report or provide the missing disclosure.

Statements for Internal Use Only

The ED recognizes that the objective of an engagement done for internal use is often different from that of an engagement contemplating third-party reliance. Thus, the procedures and reporting designed to meet the needs of third-party users wouldn't always be required for internal-use-only engagements.

As previously mentioned, many different types of engagements would be done for internal use, bounded by reviews as the highest level of service and assembly as the lowest. It is anticipated that there would be two general types of engagements that come under this umbrella. One is the consulting engagement, in which the accountant is engaged to give advice to his client regarding future operations and is expected to give some type of assurance regarding the assumptions. The ED recognizes that, because of the differing circumstances, flexibility is needed in reporting. It doesn't illustrate a report so as not to suggest that one type of report is preferable to another in this type of engagement. (However, the ED proposes that certain items be required in the report including identification of the prospective financial statements; a description of the accountant's service and the level of assurance he is giving; and a statement restricting the use of his report to internal use.)

The other general type of internal-use engagement relates to processing a client's budgets or other prospective data on the accountant's computer. The ED proposes that only two procedures be required for such a service: (1) the establishment of an understanding with the client, which may be especially important because of the limited procedures involved and the distribution restriction and (2) assembly. Since the accountant would be associated with the assembled statements, he would have to report on them, and the ED provides a sample report on this level of service. An accountant could use this example in practice by programming the report into his computer or by having it reproduced, leaving blanks for the client's name and the date of the statements. As the accountant completes the assembly, he could fill in the date and client's name and attach the report to the computer printout, meeting the ED's requirements without an appreciable increase in cost.

Because the client may expect that the accountant's involvement ensures proper disclosure, the ED proposes that an accountant's report on any internal-use-only service be required to describe the omission of required disclosures that come to his attention. The accountant wouldn't, however, be required to withdraw from the engagement or to modify his report because of a bad assumption—as long as the assumption is disclosed in the statement—because the statements wouldn't be distributed to outsiders.

The accountant would still be prohibited from being associated with prospective financial statements that omit the summary of significant assumptions. This disclosure is important even for internal-use-only statements. For example, if no assumptions are disclosed and management refers to the statements a week later, it may not remember the assumptions used—rendering the statements useless—or it may remember them incorrectly—rendering them misleading. However, the accountant wouldn't need to be concerned if sensitive assumptions aren't separately identified; presumably management would know which assumptions are sensitive.

The accountant would perform internal-use services on prospective financial statements only if he had no reason to believe they were intended for outsiders. If he believed they were intended for outsiders, he would compile or review the statements.

Putting the ED into Practice

If issued as exposed, here's how the ED might apply in practice in the four situations mentioned in the first paragraph of this article.

Situation 1. The president of a corporate client wants a forecast of his personal taxes for next year. The accountant has a form 1040 software package that, based on the assumptions input, calculates and prints a forecast in the form of a 1040. Because a 1040 doesn't include significant changes in financial position, the printout is a partial presentation, which isn't covered by the ED. The accountant would do whatever he believes appropriate considering the situation and Rule 201(e) and related interpretation. (If the software also provided the significant changes in financial position, the accountant would apply the ED and probably issue an internal-use-only report on the presentation.)

Situation 2. A corporate client needs advice to help it decide whether to lease or buy an asset and wants to know how the two alternatives would affect operations. Pro forma financial statements could be prepared in this situation to see what last year's operations would have looked like if the asset had been bought or leased. (Pro forma presentations aren't covered by the ED.) However, in this instance, the client is also contemplating other

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operating changes and believes it would be more meaningful to analyze the effect on cash in the following year, when the asset would be acquired. Two projections are prepared, one assuming the asset is purchased and one assuming the asset is leased.[14]

After discussion of the intended use of the presentation with the client, the accountant believes he can perform an internal-use-only service. (The client doesn't intend to use the presentation to get financing for the acquisition.) The accountant inputs the data into his microcomputer and applies to the assumptions whatever procedures he thinks appropriate in the circumstances. In looking at the results, the accountant notices that, under the assumptions used, the lease would be capitalizable under Financial Accounting Standards Board Statement no. 13, *Accounting for Leases*.[15] Because the client is primarily interested in his cash flow, he doesn't want the lease capitalized in the projection.

The ED's disclosure requirements call for the reconciliation of the basis of accounting used (in this case, cash) with the basis the client historically uses for financial statements (in this case, generally accepted accounting principles) but since the client doesn't want or need this disclosure, the accountant merely mentions its omission (as well as the omission of the rest of the accounting policies) in his report. The accountant completes the report illustrated in the ED and attaches it to the printout of the two projections and assumptions and gives it to the client.

Situation 3. A condominium association engages an accountant to help it develop its annual budget. The accountant can't perform an internal-use-only engagement because he knows that the budget must be distributed to all unit owners (who, like shareholders, are considered outsiders). So, the accountant compiles the budget (a forecast). The accountant, after establishing his understanding with the association, acquires knowledge about the client and its industry. If he previously audited, reviewed or compiled historical financial statements for the client, he already would have the required background knowledge of it and the industry. If not, he could rely on his knowledge gained from other clients in the industry and by inquiry of this new client.

In doing the compilation the accountant asks where the assumptions come from and is told that they are based on the previous year's results, which have been adjusted for inflation. The approach seems reasonable and the accountant has no reason to ask further questions about the assumptions at this point.

In reading the assumptions for internal consistency, the accountant notices that although the condominium association expects to take out a mortgage for its new athletic facilities, no interest expense has been budgeted. The accountant has this inconsistency corrected (or finds out where the interest expense is included); otherwise he would withdraw from the engagement if the amount was material.

Because the budget is for calendar year 1984 and the accountant is doing the work in November 1983, there are no historical results

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[14]This situation can be used to illustrate the difference between a multiple projection and two single projections. If the client expected that he would either buy the asset or lease it, he could present a multiple projection, but in this case because he is unsure whether he will obtain the asset at all, this presentation would be two projections; it isn't a multiple projection because his expectation does not necessarily fall within the range.

[15]Financial Accounting Standards Board Statement no. 13, *Accounting for Leases* (Stamford: FASB, 1976).

for an expired portion of the prospective period and he needn't perform the compilation procedure relating to those results. The accountant obtains signed representations and gives the standard report on a compilation of a forecast.

Situation 4. A client wants to promote a real estate limited partnership—a professional building—to 20 doctors. The client can't prepare a forecast because he is too unsure about certain assumptions. Instead, he decides to issue a multiple projection, which he is confident will encompass the results that will occur. A single projection, or even two projections that are not a multiple projection, would be inappropriate for this type of offering, which amounts to a general offering of equity.

The client originally requested a review, but decided that the size of the offering couldn't justify the cost of a review; accordingly, the accountant is engaged to compile the multiple projection. The accountant compiles the presentation and notes no problems. Although the prospective financial statements are presented on the tax basis of accounting, there is no requirement to reconcile the results to GAAP, provided that the historical results of the entity will also be reported on the tax basis. The accountant applies the standard procedures and gives the standard report for a compilation of a multiple projection.

Conclusion

The ED is an important document which, if issued as exposed, should have a considerable effect on a relatively new area of practice and, thus, will benefit the profession and the public. Still, the draft should be considered by all practitioners who would be affected—accounting, auditing, tax and MAS practitioners—all of whom are encouraged to respond to the draft (by May 4, 1984) in order to develop the best guidance for the profession. ■

Trailing the economy

Not surprisingly, trying to gauge an economy the size of that of the U.S. has always introduced errors into the data. The consumer price index, until it was revised . . . after a decade of debate, had overstated inflation during periods of rising interest rates. And the growth of a huge underground economy has caused the gross national product, personal income, and savings to be understated. . . .

But now economists recognize that a more fundamental problem is distorting the numbers. Increasingly, economic statistics have failed to keep up with the dizzying pace of an economy in flux. At a time when the economy is being shaped by high-technology industries and the fast-growing service sector, the data tend to emphasize older, mature, or declining industries. This makes it difficult to get a clear picture of the structure of the economy and produces distortions about economic growth and inflation.

Generally, economists maintain that most of the indicators are adequate for short-run analysis and policymaking, because by and large they track developments over the business cycle reasonably well. When policymakers and businessmen attempt to devise longer-term plans, however, they run into serious trouble. The deficiencies in the data will prove most dangerous if the government moves to take a more interventionist role in the economy, as favored by advocates of industrial policy. ''I shudder every time I think of industrial planning,'' says Pierre A. Rinfret, president of . . . a New York consulting firm. ''The first rule of such an effort is that you have to know where you are starting from. How can we hope to plan if we don't even know where we are[?]''

From ''Why Economic Indicators
Are Often Wrong''
Business Week, October 17, 1983