

Comparison of Compilation, Review, and Audit Engagements

	Compilation	Review	Audit
Assurance level	None	Limited	Reasonable
Industry knowledge	General	Enhanced	Extensive
Inquiry and analytical procedures	Not required, unless provided information is inaccurate or incomplete	Required	Required in addition to other audit procedures
Accountant/auditor independence	Not required if disclosed in report	Required	Required
Internal control understanding	Not required	Not required	Required

Choosing the Right Advisor

When you select a financial advisor, it is important that you find one who you feel comfortable working with, who understands the laws, and abides by generally accepted accounting principles. Today's CPAs provide services in many different areas, ranging from tax services to human resources consulting. Here are some other key points to consider when choosing the right advisor:

- What are your qualifications? Educational background? Special designations? Areas of expertise?
- Accountant vs. CPA – A CPA is licensed by the state, which requires passing a rigorous examination, completing attest experience and obtaining ongoing professional education to stay updated on changing laws and regulation.
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Understanding Compilations, Reviews, and Audits

Overview

Do you know whether a compilation, review, or audit of your financial statements is required? Some organizations are not clear on this. Unaudited (compilation and review) financial statements are generally prepared for management, owners, financial institutions, or other creditors. Audited financial statements are required for all public companies. In addition, certain regulatory bodies, governmental entities, or others may require nonpublic companies, nonprofits, and pension plans to have an audit of their financial statements.

Communication between the owners and management, third-party financial statement users, and the accounting firm is critical in determining which level of service, compilation, review, or audit, is requested or required. Before any services are rendered, accounting firms are required to obtain a written understanding with the client's management, known as an "engagement letter." The letter outlines the terms and objectives of the engagement, the nature and scope of services to be performed (e.g., compilation, review, or audit), and management's responsibilities.

Compilation

Preparation of financial statements based on information provided by the entity's management

A compilation is useful when limited, in-house capabilities for preparing financial statements exist.

The most significant advantage of a compiled financial statement is that it allows an accountant to render assistance with financial statements at reduced cost to a client by limiting the CPAs efforts to the mechanics of putting information in the form of the financial statements. A CPA does not have to be independent from the client to issue compiled financial statements; however, if the CPA is not independent that fact has to be disclosed in the CPA's compilation report. Further, the CPA has the option, but is not required, to disclose the reasons for independence impairment in the compilation report. If the accountant decides to disclose the reasons for independence impairment, all reasons must be disclosed.

A CPA's understanding of the accounting principles and practices used in the client's industry should be sufficient to enable compilation of the financial statements in the appropriate form. In addition, the accountant should possess knowledge of the following matters:

- Nature of the organization's business transactions
- Form of the organization's accounting records
- Stated qualifications of accounting personnel
- Accounting basis on which the financial statements are to be presented
- Form and content of the financial statements

CPAs are not required to corroborate information supplied by management for compilations. In addition, an accountant is not obligated to obtain an understanding of the organization's system of checks and balances designed to prevent and detect errors or fraud. However, an accountant is required to obtain additional or revised information if he or she becomes aware that information supplied by management is inaccurate or incomplete. Such findings or issues that, in the CPA's judgment, are significant should be documented, which should include a description of the issue and how management will resolve the issue.

Review

Inquiry and analytical procedures applied to financial statements

A review engagement requires the accumulation of review evidence that will provide the CPA with a reasonable basis for obtaining limited assurance that no material modifications need to be made to the financial statements.

The most significant difference between a compilation engagement and a review engagement is that inquiry and analytical procedures must be performed and properly documented before the CPA can express limited assurance on the financial statements. In addition, an accountant must be independent of the client for review engagements.

The CPA's inquiries should cover the following:

- Accounting principles and practices, and the methods followed in applying them
- Procedures for recording, classifying, and summarizing transactions, as well as the accumulation of information for disclosure
- Actions taken at stockholders, board of directors, and other meetings that may affect financial statements
- Inquiries of individuals having responsibility for financial and accounting matters

Analytical procedures — which often include trend analysis, ratio analysis, and reasonableness tests — identify relationships and individual items that may not be aligned with the organization's normal business practices. Results are evaluated by comparison to an organization's past performance, expected performance, and available industry data. If a CPA believes that fluctuations from expected amounts are significant, additional procedures must be performed and documented before limited assurance can be provided that no material modifications are necessary.

A review engagement requires a CPA to develop and perform analytical and inquiry procedures tailored to a client's specific industry, including the accounting principles and practices unique to such industry, and an awareness of the risk of material misstatement of the financial statements. The CPA should also have a general understanding of the client's operating characteristics and the nature of its assets, liabilities, revenues, and expenses. A CPA is not obligated to obtain an understanding of the client's internal control structure.

Audit

Confirmation with outside parties, observation of inventories, and testing selected transactions by examining supporting documents

An audit opinion represents the highest level of assurance that the financial statements fairly represent the entity's financial position and results of operation in accordance with generally accepted accounting principles (GAAP). However, the auditor can only obtain reasonable, rather than absolute, assurance that a client's financial statements are fairly presented in all material respects because of the following limitations:

- Audit procedures involve selective testing
- Evidence gathered during the audit is often suggestive rather than conclusive
- Fraud typically involves efforts by the perpetrator to conceal it through collusion, falsification of records, and providing misinformation

Auditors must comply with AICPA's Code of Professional Conduct, which requires adherence to the Statements on Auditing Standards. The auditor must exercise professional judgment and due care in the selection and application of auditing procedures. In addition to the standard unqualified audit opinion:

- Qualified opinions state that, except for the effects of the matters to which the qualification relates, financial statements are presented fairly in all material respects in accordance with GAAP.
- Adverse opinions state that financial statements are not presented fairly in accordance with GAAP.
- Disclaimers of opinions do not express an opinion on the financial statements to which they relate.
- Reports with additional explanatory language are unqualified opinions that highlight a matter related to the financial statements.

Audit engagements necessitate that auditors obtain a thorough understanding of the client's business and the industry in which it operates. The auditor must obtain an in-depth understanding of the client's internal controls, which are often documented in the form of questionnaires, flowcharts, or narratives, and assess the risk of fraud relating to the financial statements.

Side Note: In December 2009, the AICPA issued Statement on Standards for Accounting and Review Services No. 19, *Compilation and Review Engagements*. This new standard applies to compilations and reviews of financial statements for periods ending on or after Dec. 15, 2010. The key provisions of this new standard are included herein.