Herbein
CPAs + Advisors

Audit, Review, and Compilation: A Comparison of Service Offerings

The following information is provided by the Pennsylvania Institute of Certified Public Accountants. Audited, reviewed, or compiled 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.

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

Audit

Confirmation with outside parties, observation of inventories, and testing selected transactions by examining and 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 or falsification of records

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.

Review

Inquiry and analytical procedures applied to financial statements.

A review provides limited assurance that no material changes 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 CPAs 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 applied before limited assurance can be provided that no material modifications are necessary.

A CPA performing a review engagement must be aware of the unique accounting principles and practices of the client's industry. 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.

Compilation

Preparing 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 minimal 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, but that fact has to be disclosed in the CPAs compilation report.

A CPAs 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.