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FINANCIAL STATEMENT PREP, COMPILATION, REVIEW, OR AUDIT: WHICH IS RIGHT FOR YOUR ORGANIZATION?

THE RIGHT SERVICE FOR YOUR BUSINESS OR ORGANIZATION

With timely, accurate, and understandable financial statements, you get a better ideas about how your organization is doing. You have to have solid financials to make important decisions.

It's possible to prep your financial statements in house. But you might prefer the help of a professional. That way, you can be sure your financials are done according to the accounting framework that's right for your company.

Your CPA can prepare your financial statements that will meet any bank's requirements. But what if you need something more?

This document explains the differences between financial statement preparation, compilations, reviews, and audits. That way, you can decide what's right for you and your organization.

Please reach out to us if you have any questions or need of any of these services.

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FINANCIAL STATEMENT PREPARATION

- **Can help owners or those in management positions understand an organization's financial situation and strength**
- **May fulfill some lenders' documentation requirements for small loans**
- **Not a formal report and meant more as a current glimpse into a business or organization's financial standing**

Your CPA can prepare your financial statements at any frequency that's most useful. Typically, that's monthly, quarterly, or annually and usually in conjunction with bookkeeping or transaction processing services.

Your CPA can prep your financial statements according to an acceptable financial reporting framework. If you're not sure which reporting framework to use, ask your CPA to explain the pros and cons of each and the best fit for your company.

Your financial statements are primarily meant to give you current information about your organization's financial standing so you can make decisions accordingly. This service isn't much different from what an in-house controller or CFO would provide at a larger company.

You can share your financial statements with outside parties; however, on each page, your CPA will include a notice that "no assurance is provided" on the financial statements. (See sidebar for more about understanding assurance.)

Your CPA will prepare your financial statements directly from the records you provide. They won't verify the accuracy or completeness of the information and so aren't required to issue a formal report about your financial statements.

UNDERSTANDING ASSURANCE

A CPA can obtain a level of "assurance" about whether your financial statements are in accordance with the financial reporting framework. They obtain assurance by obtaining evidence.

There are different levels of assurance that can range from no assurance to the highest level of assurance, which is an audit. The level of assurance lenders require is usually based on the size of the loan, the collateral, and their determination of the overall risk.

Other situations that often require a level of CPA assurance include performance bonding and leasing. Certain trade creditors, outside investors, or family owners that are not actively involved in the business may also request or require a level of assurance on your financial statements.

If your requirements are unclear, in many cases, your CPA can talk to your lender and others about the level of service that will satisfy their requirements.

WHY PREP? Owners/management can use financial statement preparation to understand an organization's financial standing to make business decisions accordingly. This is similar to what an in-house controller or CFO would provide in a larger company.

COMPILATION

- **Usually for lenders and other outside parties that may appreciate an organization's association with a CPA without requiring a level of assurance on the accuracy of financial statements**
- **Usually appropriate when lenders or others are seeking initial or lower amounts of financing or credit or significant collateral is in place**
- **Issued as a compilation report but does not come with assurances financial standing**

In a compilation of financial statements, the role of the CPA is more apparent to outside parties. As such, the requirements are more explicit.

For example, if your CPA isn't independent from ownership or management, they have to disclose what's called an "impairment to their independence" in their compilation report. The compilation report is the first page before the actual financial statements, and your CPA should write it on their firm's letterhead.

Your CPA is also required to read the financial statements in light of the financial reporting framework they're using. They also have to consider whether the financial statements appear appropriate and are free from obvious "material misstatements." (See sidebar for understanding a misstatement and material misstatement.)

However, your CPA won't obtain any assurance for your compilation. They're not required to verify the information's accuracy or completeness or gather evidence for a review conclusion or audit opinion.

You can usually use a compilation when you're seeking initial or lower amounts of financing or credit or if you have significant collateral. Though there is no assurance with a compilation, lenders or other parties may appreciate your association with a CPA.

UNDERSTANDING A MISSTATEMENT AND MATERIAL MISSTATEMENT

A misstatement is a difference between a line item on a financial statement and what that line-item information should be so that a report is in accordance with the applicable financial reporting framework.

A material misstatement is one where the severity or nature of the difference would cause someone reviewing the statement to come to an incorrect conclusion.

A misstatement may result from fraud or error. **Note that none of these services — whether financial statement preparation, compilation, review, or audit — is designed to uncover fraud.**

COMPILATION: Usually appropriate when an organization is seeking initial or lower amounts of financing or credit, or there is significant collateral. Outside parties may appreciate the business's association with a CPA.

REVIEW

- **Provides lenders and other parties with a basic level of assurance about the accuracy of your organization's financial statements**
- **Usually used as a business or nonprofit grows and seeks larger, more complex levels of financing and credit**
- **CPA issues review report**

The review is the most basic of a CPA's assurance services. During a review, your CPA will perform analytical procedures, inquiries, and other procedures. These are meant as a way to get "limited assurance" about your organization's financial statements. They're meant to give the end user — whether that's a bank or some kind of creditor — a level of comfort about your financial statement's accuracy.

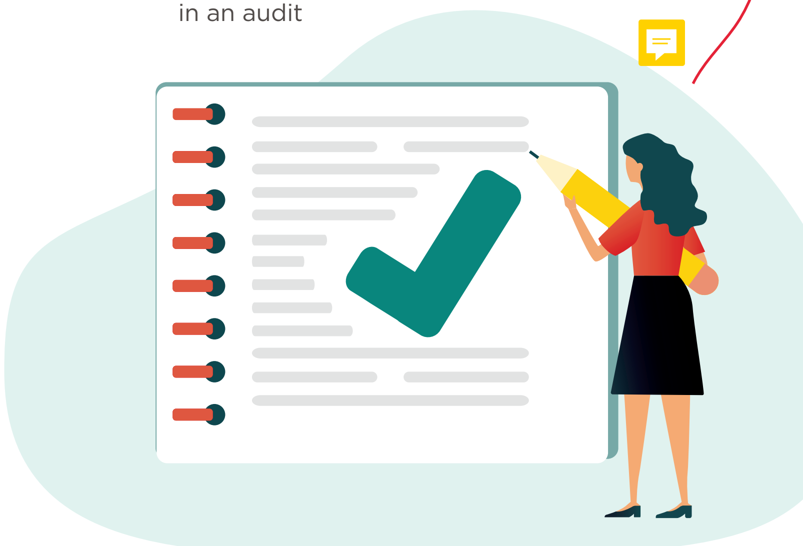
Just like during a compilation, your CPA will have to determine whether or not they're really independent. If they're not, they can't perform the review.

In a review engagement, your CPA has to understand you and your industry. This includes the accounting principles and practices those in your industry typically use. They'll use this information to identify areas in the financial statements where it's more likely that there may be material misstatements.

In a review engagement, your CPA will issue a formal report that includes a conclusion. That conclusion will note whether your CPA is aware of any material modifications you should make to your financials so they're in line with the applicable financial reporting framework.

A review is much narrower in scope than an audit. A review doesn't:

- Require an understanding of your business's internal controls
- Assess fraud risk
- Test accounting records through inspection, observation, and outside confirmation
- Examine source documents or other procedures ordinarily performed in an audit



WHEN TO REVIEW: **Often appropriate as an organization grows and seeks larger, more complex levels of financing and credit. It's also useful when owners want more confidence in their financial statements to evaluate results and make business decisions.**

AUDIT

- **Provides creditors, investors, and other parties a high level of comfort about the accuracy of your business or nonprofits financial statements**
- **Includes a formal report from your CPA with an opinion about whether the financial statements are presented fairly and in accordance with the applicable financial reporting framework**
- **Often required when you're seeking high levels of financing or outside investors or when you sell your business**

The audit is the highest level of assurance service that a CPA performs. It's meant to provide a high level of comfort about the accuracy of your organization's financial statements.

When your CPA performs audit procedures, they're doing so to obtain "reasonable assurance." That's defined as a high — but not absolute — level of assurance that your financials are free from material misstatement.

In an audit, your CPA has to understand your business's internal control and assess fraud risk. Your CPA is also required to corroborate the amounts and disclosures included in your financial statements. They do this by obtaining audit evidence through inquiry, physical inspection, observation, third-party confirmations, examination, analytical procedures, and other procedures.

For an audit, your CPA has to determine whether their independence is impaired. Like during a review, if their independence is impaired, they can't do the audit.

Your CPA will issue a formal report that expresses an opinion about whether or not your financials are presented fairly and according to the applicable financial reporting framework. In addition, Also, your CPA must report to you any significant or material weaknesses in your system of internal control.

An audit's usually required when you're seeking complex or high levels of financing and credit. It's also appropriate if you're looking for investors or preparing to sell or merge with another business.

WHEN TO AUDIT: **An audit is appropriate and often required when an organization seeks complex or high levels of financing and credit. Also appropriate when an organization is looking for outside investors, seeking to sell the business, or considering a merger.**

	FINANCIAL STATEMENT PREP	COMPILATION	REVIEW	AUDIT
LEVEL OF ASSURANCE	CPA doesn't obtain or provide any assurance	CPA doesn't obtain or provide any assurance	CPA obtains limited assurance	CPA obtains "reasonable assurance"
USED TO DETECT FRAUD	No	No	No	No
CPA REQUIRED TO BE INDEPENDENT	No	No	**YES**	**YES**
CPA REQUIRED TO OBTAIN AN UNDERSTANDING OF INTERNAL CONTROL AND FRAUD RISK	No	No	No	**YES**
CPA REQUIRED TO PERFORM INQUIRY AND ANALYTICAL PROCEDURES	No	No	**YES**	**YES**
CPA REQUIRED TO PERFORM VERIFICATION AND SUBSTANTIATION PROCEDURES	No	No	No	**YES**
CPA ISSUES A FORMAL REPORT	No	**YES**	**YES**	**YES**
DIFFERENCES IN TIME REQUIRED	Varies based on the financial records provided	Least time consuming of the services in which the CPA issues a formal report	More time consuming than a compilation but much less than an audit	Involves the most work and CPA time

CHOOSING YOUR SERVICE:
You can use the chart above to help you decide whether a financial statement preparation, compilation, review, or audit might be right for your organization.

Contact us today to find the right service for your organization.

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