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## **Review engagements – new and expanded guidance on analytical procedures, inquiries, and other procedures**

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Lorie L. Pombo

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**AICPA Audit and Accounting  
Practice Aid Series**

**Review Engagements —  
New and Expanded Guidance  
on Analytical Procedures,  
Inquiries, and Other Procedures**

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**AICPA**

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**Review Engagements —  
New and Expanded Guidance  
on Analytical Procedures,  
Inquiries, and Other Procedures**

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AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

**AICPA**



## Notice to Readers

This publication, *Review Engagements—New and Expanded Guidance on Analytical Procedures, Inquiries, and Other Procedures*, is a practice aid that helps CPAs perform more effective review engagements and understand and implement recent standards.

This practice aid is an Other Compilation and Review Publication as defined in Statement on Standards for Accounting and Review Services (SSARS) No. 11, *Standards for Accounting and Review Services* (AICPA, *Professional Standards*, vol. 2, AR sec. 50). Other Compilation and Review Publications have no authoritative status; however, they may help the accountant understand and apply the SSARS.

If you apply the guidance included in an Other Compilation and Review Publication, you should be satisfied that, in your judgment, it is both appropriate and relevant to the circumstances of your engagement. This Practice Aid has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA, and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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## **INTRODUCTION**

*Review Engagements—New and Expanded Guidance on Analytical Procedures, Inquiries, and Other Procedures* is a practice aid designed to help CPAs perform more effective review engagements and to implement Statement on Standards for Accounting and Review Services (SSARS) No. 10, *Performance of Review Engagements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100). This practice aid clarifies certain existing SSARS, suggests ways of implementing existing and new standards in special circumstances, and provides practical guidance to help implement the changes to SSARS No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100).

## **OVERVIEW OF A REVIEW ENGAGEMENT AND THE CHANGES MADE BY SSARS No. 10**

A review of financial statements under SSARS No. 1 consists of two phases. First, through inquiry and analytical procedures, you gather a limited amount of information to determine whether a client’s financial statements are presented in accordance with generally accepted accounting principles (GAAP).<sup>1</sup> Second, based on the limited amount of information you collect, you express limited assurance on the financial statements. That limited assurance states that you “are not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with GAAP.”

The fundamental steps in the review engagement are as follows:

- Develop an understanding of the accounting principles and practices used in the client’s industry.
- Develop a general understanding of the client’s organization; its operating characteristics; and the nature of its assets, liabilities, revenues, and expenses.
- Make appropriate inquiries of the client.
- Perform appropriate analytical procedures.
- Read the client’s financial statements.

SSARS No. 1 has always provided guidance on analytical procedures, inquiries, and other procedures applicable to a review of financial statements. However, SSARS No. 10 amends SSARS No. 1 by providing:

- New and expanded guidance on analytical procedures, including specific guidance on developing expectations

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<sup>1</sup>Throughout this publication, any reference to GAAP includes, where applicable, comprehensive bases of accounting other than GAAP, such as cash or tax basis.

- New and expanded guidance on inquiries, including specific new inquiries to be directed to management
- New inquiries regarding fraud in a review engagement
- New written representations regarding fraud in the management representation letter
- Clarification of guidance regarding working paper documentation in a review engagement, including a requirement to document expectations developed in performing analytical procedures in which significant expectations are not otherwise readily determinable

Since SSARS No. 1 was issued in 1978, there has been no substantial change to the requirements for a review engagement. Over time, as a result of feedback from the peer review process, the Accounting and Review Services Committee (ARSC) became aware of the need to update and expand the guidance related to inquiries and analytics in review engagements.

Since a review engagement provides limited assurance that no material modifications need to be made to the financial statements for them to be in conformity with GAAP, and because financial statement misstatements could be intentional (fraud) or unintentional (error), ARSC felt that CPAs should make inquiries related to fraud in a review engagement.

Given the conclusion related to the required inquiry about fraud, ARSC also felt that there should be written representations about fraud in the management representation letter.

ARSC also felt that there were questions about documentation related to review engagements, partly due to the fact that the SSARS do not provide enough specific documentation guidance for practitioners to use related to this issue.

The expanded illustrative inquiries (in Appendix B of SSARS No. 1) relate to the fact that the illustrative inquiries had not been updated since 1978. Many of the illustrative inquiries had become dated and, primarily because of new technical literature, there was a need to provide more comprehensive guidance related to these inquiries.

## **KNOWLEDGE OF ACCOUNTING PRINCIPLES AND PRACTICES**

Procedures for conducting a review of financial statements generally are limited to inquiries and analytical procedures. The specific inquiries made and analytical procedures performed should be tailored to the engagement based on your knowledge of the client's business and industry.

The performance of a review engagement assumes that you have an adequate understanding of accounting principles and practices of the client's industry. Review procedures can be performed effectively only if you are familiar with the industry-specific accounting principles used by the client.



**Practice Pointer.** You can obtain an understanding of specialized accounting principles by referring to appropriate material. For example, you may:

- Review relevant AICPA Audit and Accounting Guides.
- Review financial statements of other entities in the same industry.
- Consult with other individuals familiar with accounting practices in the industry.
- Read relevant AICPA industry Audit Risk Alerts.
- Read periodicals, textbooks, and other publications that discuss financial accounting and reporting practices.
- Attend seminars conducted by accounting and industry groups.

For many review engagements, the client does not use specialized or unique accounting practices. In this case, a knowledge of GAAP or an other comprehensive basis of accounting, as they relate to all entities, is sufficient background to execute a review effectively.

If the client operates in an industry characterized by specialized accounting principles, you should be familiar with that industry's specialized accounting principles, practices, and methods.

You should also develop an understanding of the client's organization with regard to accomplishing its business objectives. Whereas the understanding of the client's organization need only be general, you must be able to relate the fundamental structure of the client to implications for the financial statements. SSARS No. 1 does not elaborate on which specific factors of the client's organization should be understood, but the types of factors you may want to consider include the following:

- Legal form of business organization (that is, corporation, partnership, sole proprietorship, etc.)
- History of the client to aid in understanding the financial statements
- Principals and key personnel
- Organization chart

SSARS No. 1 states that you should obtain a general understanding of the client's operating characteristics as part of the review engagement. This understanding would include the following:

- Understanding the client's products and services
- Identifying the client's operating locations
- Understanding the client's production methods
- Understanding the client's distribution system
- Understanding the client's compensation methods
- Identifying material transactions with related parties

An understanding of the client's operating characteristics can be obtained by making inquiries of the client's principals and key personnel, and by observing the client's operations.

Developing an understanding of the accounting principles used in the client's industry and a general understanding of the client's business (client's organization and operating characteristics) provides a basis for understanding the nature of the client's assets, liabilities, revenues, and expenses.

## **ANALYTICAL PROCEDURES**

Analytical procedures involve the study, comparison, and evaluation of relationships among financial and nonfinancial data at a point in time and the trend in those relationships over a period of time. A basic premise underlying analytical procedures is that plausible relationships among data may reasonably be expected to exist in the absence of known conditions to the contrary. Particular conditions that can cause variations in these relationships include, for example, specific unusual transactions or events, accounting changes, business changes, random fluctuations, or misstatements.



**Practice Pointer.** Note that there is a subtle difference between analytical procedures performed for an audit engagement and a review engagement. This difference is based on the desired level of assurance. In an audit, the analytical procedures are designed to provide reasonable assurance that the financial statements are fairly presented. In an audit, the analytical procedures are used as an aid to the auditor in planning the nature, timing, and extent of other auditing procedures; as a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions; and as an overall review of the financial information in the final review stage of an audit. In a review, they are performed in connection with inquiries of management to provide moderate assurance that you are not aware of any material misstatements.

In a review, the objectives of analytical procedures are to:

- Provide a basis for the limited assurance provided in the review report.
- Identify financial statement items that appear to be materially misstated.

Analytical procedures will often provide a basis for additional inquiries, because the procedures may bring to your attention other significant matters affecting the financial statements that might otherwise not have been apparent.

There are two general steps in performing analytical procedures:

- Develop expectations by identifying and using plausible relationships that are reasonably expected to exist, based on your understanding of the entity and the industry in which the entity operates.
- Compare the recorded amounts, or ratios developed from recorded amounts, to the expectations you developed.

### **Types of Analytical Procedures**

There are various types of analytical procedures that you can use to evaluate the reasonableness of the financial information, ranging from simple comparisons to complex models involving

many relationships and elements of data. The following are the three broad types of analytical procedures commonly used by accountants:

- *Trend analysis* is the comparison of a recorded amount to the prior-year balance or to a trend of balances from two or more periods. A common example is comparing monthly totals for sales for the current and preceding year.
- *Ratio analysis* is the comparison of a ratio calculated for the current period to a related or similar ratio for a prior period, an industry standard, or a budget. Financial and operating ratios are commonly classified into four major categories: liquidity, profitability, leverage, and activity ratios.
- *Model-based procedures (reasonableness tests)* are the use of client operating data and the relevant external data (industry information and general economic information) to develop an expectation for the recorded amount. These procedures typically use operating and external data in addition to financial data to perform reasonableness tests. For example, the number of employees can be used to determine average wages or vacation pay per employee.

In practice, a specific analytical procedure takes on characteristics of all three types of procedures (trend analysis, ratio analysis, and reasonableness tests). For example, the results of computing the current ratio (ratio analysis) are compared to current ratios of previous years (trend analysis) and evaluated based on your understanding of current factors affecting the client's working capital accounts (test of reasonableness).

Whatever type of analytical procedures is used, these procedures include comparisons of key financial data to:

- Prior-period financial information
- Budgeted and forecasted financial information
- Similar information regarding the industry in which the entity operates
- Nonfinancial information that may affect financial information

### ***Comparison of Current Financial Data to Prior Periods***

The method most commonly used in practice is comparison with amounts from prior periods. This involves using financial information for the comparable prior period(s) (giving consideration to known changes) to develop expected amounts and comparing these expected amounts with current-year recorded amounts.

A variety of techniques are used to facilitate comparisons, including trend analysis and ratio analysis. Common examples include comparisons of the following:

- The current year's account balance with that of a prior year
- The detail of the current year's account balance with that of a prior year

- Current-year ratios with those of the prior year
- Current-year percentage relationships with previous years

### ***Comparison of Current Financial Data to Budgets and Forecasts***

Although many small businesses do not prepare meaningful budgets or forecasts, comparison with carefully prepared budgets and forecasts may be very effective. Even if financial budgets or forecasts are not prepared, some companies maintain manufacturing or production budgets that may be very effective for certain analytical purposes.

Keep in mind, however, that management may be motivated to manipulate financial results to meet budgets or forecasts, and that budgets or forecasts may be used more for motivational purposes than as realistic expectations.

### ***Comparisons to Industry Data***

Published industry data can provide a rich source of information for analytical procedures. If a client differs from the other firms in the industry with respect to characteristics such as ownership or financial structure, product diversity, age of assets, or customer mix, the industry ratios may not be meaningful or may need to be adjusted.

Some of the more commonly available sources of general industry data include:

- *Annual Statement Studies*, Robert Morris Associates ([www.rmahq.org](http://www.rmahq.org))
- *Cost-of-Doing-Business Series*, Dunn & Bradstreet ([www.dnb.com](http://www.dnb.com))
- *Financial Studies of the Small Business*, Financial Research Associates ([www.frafssb.com](http://www.frafssb.com))
- *Key Business Ratios*, Dunn & Bradstreet ([www.dnb.com](http://www.dnb.com))
- *Mergent OTC Industrial Manual*, Moody's Investor Service ([www.mergent.com](http://www.mergent.com))
- *Almanac of Business and Industrial Financial Ratios*, Aspen Publishers ([www.aspenpublishers.com](http://www.aspenpublishers.com))

In addition, a number of industry trade organizations publish industry data. If your client is a member of an industry trade organization, you may be able to receive data directly from the organization.

### ***Comparisons Using Nonfinancial Information***

A client may generate a variety of nonfinancial data that may be used to make comparisons with recorded amounts. Examples of this data include:

- Production in units
- Direct labor hours
- Number of sales calls

- Size of sales staff
- Square feet of selling space

Because nonfinancial operating data often are generated and maintained outside of the accounting department, comparisons involving such data can offer an independent check on the reasonableness of related financial information. Tests involving nonfinancial data are sometimes referred to as *reasonableness tests* since nonfinancial data are used to determine the reasonableness of amounts recorded in the financial information.

### **Trend Analysis**

The comparisons employed in trend analysis most often involve using annual or aggregate data. However, trend analysis may also be performed with monthly or quarterly data.

The period-to-period change method uses (1) the absolute change or (2) the rate of change to predict the amount for the current period.

Exhibit 1, “Trend Analysis,” illustrates these two forms of analysis. In the absolute change method, to predict sales for year 3, add the increase (or decrease) in sales between year 1 and year 2 to the amount in year 2. To predict the sales for year 3 using the rate of change method, multiply one plus the percentage of change between year 1 and year 2 by year 2’s sales.

#### **Exhibit 1** Trend Analysis

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##### **Historical Sales Data**

20X3	\$456,000
20X4	\$504,000

##### **Absolute Change Method**

$$\begin{aligned}\text{Predicted Sales for 20X5} &= 20X4 \text{ Sales} + (20X4 \text{ Sales} - 20X3 \text{ Sales}) \\ &= \$504,000 + (\$504,000 - \$456,000) \\ &= \$504,000 + \$48,000 \\ &= \$552,000\end{aligned}$$

##### **Rate of Change Method**

$$\begin{aligned}\text{Predicted Sales for 20X5} &= 20X4 \text{ Sales} \times (20X4 \text{ Sales} \div 20X3 \text{ Sales}) \\ &= \$504,000 \times (\$504,000 \div \$456,000) \\ &= \$504,000 \times 1.1053 \\ &= \$557,053\end{aligned}$$

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## **Ratio Analysis**

Ratio analysis enables you to incorporate into comparisons a knowledge of relationships between financial statement amounts. Therefore, it can be used to make comparisons with ratios developed from comparable prior periods or with ratios of other firms.

Profitability ratios are particularly useful in finding misstatements of net income. The ratios might also lead to the detection of the overstatement of assets (understatement of expenses) or the understatement of liabilities (overstatement of revenue).

Ratio analysis is most appropriate when the relationship between accounts is fairly predictable and stable. Ratio analysis can be more effective than trend analysis because comparisons between balance-sheet accounts and income statement accounts can reveal unusual fluctuations that an analysis of only one account may not.

Ratio analysis may be performed using financial ratios or using common-size statements. Significant ratios for many small business engagements include profitability, activity, leverage, and liquidity.

### ***Profitability Ratios***

Profitability ratios are as follows:

- Return on sales = Net income ÷ Net sales
- Return on total assets = Net income ÷ Total assets
- Return on equity = Net income available to common stockholders ÷ Average common stockholders' equity
- Gross profit percentage = Gross profit ÷ Net sales
- Percentage change in sales = (Current year's net sales – Last year's net sales) ÷ Last year's net sales

### ***Activity Ratios***

Activity ratios are as follows:

- Receivables turnover = Credit sales ÷ Average net receivables
- Days sales in accounts receivable = 360 ÷ Receivables turnover
- Inventory turnover = Cost of sales ÷ Average inventory
- Days inventory = 360 ÷ Inventory turnover

### ***Leverage Ratios***

Leverage ratios are as follows:



- Debt to assets = Total debt ÷ Total assets
- Debt to equity = Total debt ÷ Total equity
- Coverage ratio = (Net income + Interest expense) ÷ Interest expense
- Cash flow to total debt = Net cash flow ÷ Total debt


### **Liquidity Ratios**

Liquidity ratios are as follows:

- Current ratio = Current assets ÷ Current liabilities
- Acid test ratio (or quick ratio) = Quick assets ÷ Current liabilities
- Working capital turnover = Net sales ÷ Average working capital

The common-size statement method involves displaying each financial statement amount as a percentage of a related base, such as total revenues or total assets. Common-size statements are especially useful, because many expenses bear a normal relationship to total revenues. Common-size statements may also be needed for comparison with industry data.

To use ratio analysis effectively, you should be aware of the relationship between the items used in calculating the ratio. For example, in comparing the gross profit percentage of a company over time, you should remember that this ratio may be affected by the fact that cost of goods sold is made up of fixed and variable costs and the fact that the sales mix may have changed.

 **Practice Pointer.** Additional guidance for performing analytical procedures may be found in Statement on Auditing Standards (SAS) No. 56, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 329), as amended, and in the AICPA's Audit Guide entitled *Analytical Procedures*.

## **Selection of Analytical Procedures**

Although professional judgment must be used in the selection of analytical procedures, you should consider the following practical guidelines when making the selection.

### ***Nature of the Assertion***

Focusing on the assertion that the analytical procedure is designed to address often clarifies the selection. The focus may be on existence, rights and obligations, completeness, valuation, or presentation.

### ***Plausibility and Predictability of the Relationship***

Analytical procedures are used based on the assumption that plausible and predictable relationships exist among the financial and nonfinancial data. The more plausible and predictable the re-

relationship, the more assurance can be derived from the procedure. However, it is also important to understand that some data may appear to be related, but are not.

Relationships in a stable environment are usually more predictable than relationships in a dynamic or unstable environment, and those relationships involving income statement accounts tend to be more predictable than relationships involving only balance-sheet accounts. The reason is that income statement accounts represent transactions over time, and balance-sheet accounts represent amounts as of a point in time.

Relationships involving transactions subject to management discretion are sometimes less predictable, such as in the situations in which management elects to incur large amounts of maintenance expense rather than replace plant and equipment, or a situation in which management delays advertising expenditures.

### ***Level of Detail***

The information that is gathered from applying analytical procedures is quite broad. For this reason, analytical procedures are most useful when they are applied to disaggregated data. For example, it is generally more useful to compute the gross profit margin for a single product line than for the company as a whole.

### ***Materiality***

Analytical procedures should be applied to account balances that, if misstated, could have a material effect on the financial statements. Also, the range of acceptable balances varies depending on the materiality of the account under investigation. Although you should be most concerned with material balances, individually immaterial balances that are collectively material cannot be ignored.

### ***Previous Errors***

If the review is a continuing engagement, errors discovered in previous engagements should be used as a guide in the selection of analytical procedures. For example, if, in the previous review, you discovered that the client did a poor job in performing a proper year-end cutoff of inventory purchases, appropriate analytical procedures should be used during the current engagement to make sure the error has not been repeated.

### ***Complex Transactions***

If the client has engaged in complex transactions during the period, you should conform analytical procedures to these transactions to determine whether the overall account balances are consistent with your expectations.

## **Expectations**

The development of expectations about a client is highly judgmental. Although expectations developed in performing analytical procedures in connection with a review ordinarily are less encompassing than those developed in an audit, you must be able to assimilate a wealth of information into a series of logical and internally consistent expectations. In developing expectations, you should be aware of three fundamental categories of information:

- Broad economic conditions
- Industry-specific conditions
- Client-specific conditions

### ***Broad Economic Conditions***

Broad economic conditions establish the background for developing expectations. You should stay informed of the regional and national economy, because these factors can have a significant effect on the client and ultimately on the client's financial statements. For example, if interest rates are on an upward trend, you would expect the client's interest costs (assuming the amount of debt outstanding is relatively stable and its maturity is short term) to increase compared with the previous year's results.

### ***Industry-Specific Conditions***

The conditions that characterize the client's industry provide information that allows you to formulate more detailed expectations. These conditions include the economic cycle of the industry, the maturity of the industry, the pace of technological change within the industry, and relevant governmental regulations. For example, if the client's industry is in the trough of an economic cycle, you would expect excess operating capacity to create significant volume variances that would affect the gross profit margin and the client's overall profitability.

### ***Client-Specific Conditions***

Generally, awareness of the factors unique to a client is obtained through inquiry or prior knowledge of the client. As discussed later in this publication, inquiries should be directed at obtaining a general understanding of the client's organization and operating characteristics and the nature of its assets, liabilities, revenues, and expenses. For example, you should develop a knowledge of the client's production and compensation methods, distribution system, operating locations, material transactions with related parties, and products and services. You may have developed such knowledge as a result of prior review engagements and other services for the client. For example, based on prior engagements, you may be aware that the client usually makes costing errors when pricing certain raw materials.

There is an interrelationship between analytical procedures performed and your knowledge of the client and the industry in which it operates, in that this knowledge is essential to interpret the results of the procedures and to determine when a difference from an expected amount is significant.

It is important to know when fluctuations from previous periods result from changed conditions (e.g., major increases in product selling price, inventory obsolescence, a change in credit policy).

It is equally important to identify when an item is supposed to fluctuate but does not. For instance, suppose the gross profit percentage remains substantially the same, even though there have been significant increases in raw material costs and no major price increases.

A good source of information to keep up to date on economic and industry trends is the AICPA's annual Audit Risk Alert series. In addition to the *General Audit Risk Alert*, the AICPA also publishes the following industry risk alerts:

- Construction Contractors
- Depository and Lending Institutions
- Employee Benefit Plans
- Health Care
- High Technology
- Insurance
- Investment Companies
- Manufacturing
- Not-For-Profit Organizations
- Real Estate
- Securities
- State and Local Governments

## **Evaluating Results**

The actual result of applying a specific analytical procedure to the client's financial information should be evaluated in light of your original expectation of the result. In making the evaluation, you should emphasize objective analysis rather than rationalization. Objective analysis is concerned with evaluating the results of the analytical procedure to determine whether the result is consistent with the expectation. Rationalization is characterized by searching for conditions that support a result without identifying, for example, which conditions are the most important, most logical, and most relevant to the evaluation.

Comparing actual results to expected results requires that you develop guidelines on what a significant fluctuation is. For example, a client's gross profit margin might be 47 percent this year compared to 45 percent last year, and you have the expectation that, in general, there is no reason to expect a change in the gross profit margin. Is the two-percentage-point difference significant?

In determining whether a difference between an actual result and an expected one is significant, you must relate the item being analyzed to thresholds established for the engagement. For example, in the case of the gross profit percentage difference of two points, you may have determined that an item is potentially material if operating income could be misstated by 7 percent or current assets could be misstated by 9 percent. Initially, the two-percentage-point difference should be treated as an error, converted to a dollar amount, and related to (1) operating income (cost of goods sold understated and tax expense understated) and (2) current assets (ending inventories overstated).

It should be emphasized that the materiality analysis is preliminary and is performed to provide you with some direction. If the assumed error is clearly immaterial, you generally would not investigate the matter further. If the assumed error is material or approaches the materiality threshold, you should consider additional investigation, including making inquiries, performing other analytical procedures, and performing nonanalytical procedures, such as recomputing information. In the above example, you may decide to review the client's inventory count procedures or test the costing on the inventory summarization.

Care must be exercised in making comparisons with prior-period amounts. If conditions have changed, the comparability of amounts or ratios may be affected. For example, inventory accounts may illustrate only a slight change in relation to the prior years' balances. On the other hand, you may be aware of a curtailment in production late in the current year that should have resulted in a significant amount of inventory liquidation. Remember, the absence of an expected change may also be significant. For example, in computing gross profit percentages, you may discover that the percentage is essentially the same for each year. This does not necessarily mean that the results do not require additional investigation. In other words, the comparison should be based on expected results for the current year. Therefore, in the current engagement, you may discover that the gross profit for a line of products had been significantly reduced because a competitor began to sell a similar product during the current year. You should investigate the lack of change in gross profit percentages as an error that could have a material effect on the financial statements.

Many accountants have difficulty with analytical procedures in situations in which conditions have changed and a significant difference is expected in the data, but the difference does not exist because of a misstatement. In these situations, there is no substitute for a thorough knowledge of the client's business and how it has changed in the current year. It often helps to ask yourself, "Based on what I know about the business, should the ratios for the prior years be comparable to this year?"



**Practice Pointer.** SSARS No. 10 does not define the term *significant expectations*. Instead, you will have to use your professional judgment to determine whether the expectation you developed is significant and whether the expectation is readily determinable from documentation of the work performed.

## Documentation of Analytical Procedures

SSARS No.1, as amended, requires you to document the analytical procedures performed and the expectations that you developed, if significant expectations are not otherwise readily determinable from the documentation of the work performed, along with the factors that you considered in the development of those expectations. Exhibit 2, “Illustration of Documentation—Analytical Procedures,” illustrates the way in which analytical procedures for revenue might be documented in the working papers.

### Exhibit 2 Illustration of Documentation—Analytical Procedures

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#### Revenue—Analytical Procedures

12/31/X5

Recorded Balance	\$11,540,500
Expectation for X5	<u>11,434,000</u>
Absolute Difference	<u>\$ 106,500</u>
Relative Difference	<u>0.92%</u>

Difference appears reasonable; procedure supports that revenue is not materially misstated.

The expectation was developed using the prior year’s reviewed sales balance and adjusting for a 3.4 percent average sales increase and a 2 percent increase in sales volume based on shipping data. Reports of product sales were reviewed and compared to prior year’s reports. No significant changes in sales mix were noted.

#### Calculation of Expectation

Revenue for the year ended 12/31/X4	\$10,841,200
Multiply: Sales volume increase	x <u>1.02</u>
	\$11,058,024
Multiply: Average sales increase	x <u>1.034</u>
Expectation for X5	<u>\$11,433,997</u>

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## **Engagement Efficiency**

In a review engagement, the following steps may help improve efficiency:

- Omit or limit comparisons of current-year financial data to budgets or forecasts if prior experience with the client has shown that the budgets and forecasts are unreasonable, unrealistic, or do not represent management's best estimate.
- Before spending any amount of time performing analytical procedures involving comparisons with industry data, evaluate whether the client's line of business is the same as the industry standards and whether there is significant variation in the data reported and in the structure of the companies.
- When planning analytical procedures, determine the extent and availability of client-prepared financial and operating data and become familiar with such information. Most entities develop a vast amount of information to help management analyze operations and make business decisions. Before spending the time to accumulate and analyze such information, any internally prepared management reports and analyses that would serve the same purpose should be obtained.
- Sometimes accountants tend to perform an excessive number of analytical procedures and ratios regardless of their relevance to the engagement. Before performing an analytical procedure or ratio, ask, "What type of useful evidence will this relationship provide?"

In applying analytical procedures in a review engagement, both effectiveness and efficiency may be achieved by using the following approach:

1. Identify immaterial account balances or classes of transactions. Do not apply analytical procedures to them.
2. Identify account balances or classes of transactions to which you have applied other accounting services (bookkeeping or payroll services, for example). Consider the information that you already have and whether any material errors are likely to remain. If you believe you already have sufficient evidence for those account balances or classes of transactions to reduce the risk of material misstatement to a moderate level, do not apply analytical procedures to them.
3. For the remaining account balances and classes of transactions, develop expectations (for example, using historical trends adjusted for known changes) for them.
4. Consider how close the existing account balance or class of transaction comes to the expectation developed in item 3. If the differences are small, no additional evidence is needed.
5. If the differences are large, material errors could exist. Inquire about valid business reasons for the difference. If the results of inquiry are plausible and agree with other information, no additional evidence may be needed.

6. If additional information is needed, apply other analytical procedures or obtain other suitable evidence.

Overall, the purpose of the inquiries and analytical procedures is to provide you with the primary basis for expressing limited assurance that no material modifications should be made to the financial statements. SSARS No. 1 does not specify how many procedures must be performed in order to express the limited assurance. The extent and type of procedures performed is a matter of professional judgment.

Keep in mind, too, that SSARS allow the modification of inquiry and analytical procedures. For example, you may have acquired knowledge about the entity in the performance of audits of the entity's financial statements, the compilation of the entity's financial statements, or other accounting services (such as bookkeeping services). This acquired knowledge may be sufficient to reduce the extent of inquiries and analytical procedures, although you would have the same degree of responsibility with respect to the financial statements (expressing limited assurance that no material modifications should be made to the financial statements).

### **Analytical Procedures in Initial Review Engagements**

Accountants often question how to apply analytical procedures on initial review engagements. For example, how can you evaluate the results of procedures applied for the current year if you are unsure whether amounts are comparable to prior years or whether the company is newly formed? Recall, from the previous section, that SSARS allow you to modify your inquiries and analytical procedures based on the knowledge acquired in performing other services. Although SSARS No. 1 does not cite initial engagements as a situation in which you may choose to modify your inquiries and analytical procedures, it is reasonable to assume that these procedures could be modified in initial engagements.

In initial review engagements, you may have to rely on other sources of evidence. For example, you may have to rely on making additional inquiries. Furthermore, you may have already compiled the financial statements, or may have provided other accounting or bookkeeping services for the client. In these cases, you may rely on knowledge gained from these other services to supplement the limited analytical procedures that can be performed because of insufficient history. Your analytical procedures may also consist of comparisons with results for similar clients or to industry statistics, and of analysis of the interrelationships between accounts.

## **INQUIRIES**

Inquiries are a fundamental technique used in a review engagement to collect information relevant to the financial statements.





**Practice Pointer.** Note that SSARS No. 10 amends SSARS No. 1 to specifically require that certain inquiries be made of “members of management who have responsibility for financial and accounting matters.” Previously, SSARS No. 1 did not specify that the inquiries be directed to members of management.

## **Types of Inquiries**

Because of the nature of the inquiry technique, there is no complete list of inquiries that should be made in a review engagement. However, SSARS No. 1 states that you should consider making the inquiries described in the following sections.

### ***Inquiries to Members of Management***

As part of the review, you should make inquiries to the members of management who have responsibility for financial and accounting matters concerning the areas described in the following sections.

**Inquiries concerning conformity with GAAP.** You should make inquiries to determine whether the financial statements have been prepared in conformity with GAAP and whether there have been changes in the application of accounting principles. If such changes have occurred, inquiries should be made to determine whether the changes are appropriate and, if so, whether the changes have been accounted for and disclosed in a manner consistent with Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*.

**Inquiries concerning the entity’s accounting principles.** As discussed earlier, you should be aware of which accounting procedures the client uses. Accounting procedures should be adequate to record, classify, and summarize transactions and accumulate information for disclosure in the financial statements in a manner that conforms to GAAP. The understanding of the nature of the client’s accounts provides you with background to determine whether the accounting procedures used are appropriate for the client’s industry.

**Inquiries concerning unusual or complex situations.** The following are examples of situations that may have an effect on the financial statements about which you would ordinarily inquire:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a business segment
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments
- Adoption of new stock compensation plans or changes to existing plans
- Significant, unusual, or infrequently occurring transactions

- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Application of new accounting principles
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates
- Compliance with debt covenants
- Changes in related parties or significant new related parties
- Material off-balance-sheet transactions, special-purpose entities, and other equity investments
- Unique terms for debt or capital stock that could affect classification

**Inquiries concerning significant transactions.** You should make inquiries about any significant transactions that occurred or were recognized near the end of the reporting period.

**Inquiries concerning the status of uncorrected misstatements.** You should make inquiries about whether adjustments have been recorded subsequent to a previous engagement and, if so, the amounts recorded and the period in which such adjustments were recorded.

**Inquiries concerning matters about which questions have arisen.** You should make inquiries if questions have arisen in the course of applying the review procedures.

**Inquiries concerning subsequent events.** You should make inquiries concerning events that occur subsequent to the date of the financial statements that could have a material effect on the financial statements. Such events should be judged to determine whether they require an adjustment to or a disclosure in the reviewed financial statements.

**Inquiries concerning fraud.** You should make inquiries regarding management’s knowledge of any fraud or suspected fraud affecting the entity involving management or others if the fraud could have a material effect on the financial statements; for example, communications received from employees, former employees, or others.



**Practice Pointer.** ARSC issued SSARS Interpretation No. 26, “Communicating Possible Fraud and Illegal Acts to Management and Others,” of SSARS No. 1 (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.26), in conjunction with SSARS No. 10. This new Interpretation provides guidance as to the steps you should take to perform the required communication when, during the performance of a compilation or review engagement, you suspect that fraud or an illegal act may have occurred. A copy of this interpretation is included in Appendix C of this Practice Aid.

**Inquiries concerning significant journal entries.** You should make inquiries concerning any significant journal entries and other adjustments.

**Inquiries concerning communications from regulatory agencies.** You should make inquiries about any communications the client has received from regulatory agencies.

### ***Inquiries Concerning Actions Taken by the Board***

As part of the review, you should make inquiries concerning actions taken at meetings of shareholders, board of directors, committees of board of directors, or comparable meetings that may affect the financial statements. Matters that would be relevant include:

- Approval of key-employee stock option plans
- Approval of officer compensation
- Approval of loan agreements
- Approval of the disposition of specific assets or segments of the business
- Declarations of stock, cash, or other dividends

### **Nature of the Inquiry Process**

Although the process of inquiry is simple, successful use of the technique depends on the individual who makes the inquiry. Specifically, you must know what questions to ask and how to pursue a particular line of questioning aggressively. The quality of the review engagement is reduced dramatically if you perform inquiries in a mechanical fashion and accept responses from client personnel without critical evaluation.

A variety of questions apply to almost all review engagements, and these questions are often found on engagement checklists. Most of these “standard” questions are asked in a somewhat formal manner, with the CPA interviewing appropriate client personnel and recording their responses directly in the working papers.

Nevertheless, inquiry certainly should not be limited to this formal process. Inquiry is pervasive in a review engagement, and it should be viewed in a more dynamic fashion as a dialogue. As you become aware of a circumstance, fact, or relationship, you will logically see a number of questions that should be asked. On the basis of responses given by the client, the direction of the questioning may change, or it may stop because you are satisfied with the answer. In a review engagement, the inquiry process should be an ongoing activity, reflecting your inquisitive nature.



**Practice Pointer.** ARSC updated the illustrative inquiries found in an appendix of SSARS No. 1. Many of the illustrative inquiries had become dated and, primarily because of new technical literature, there was a need to provide more comprehensive guidance related to these inquiries. A copy of these illustrative inquiries is included in Appendix B, “Review of Financial Statements—Illustrative Inquiries,” of this Practice Aid.

## **Developing Inquiries**

There is no way to script the inquiries that should be made in a review engagement. Each engagement is unique and each CPA is unique. Nonetheless, inquiries should be focused and relevant. Asking irrelevant questions results in an inefficient review engagement and, perhaps worse, can undermine client confidence.

Focusing on the following five categories of assertions that the client includes, explicitly or implicitly, in the financial statements provides an overall focus for the inquiry process:

- *Existence or occurrence.* Confirm that the reported assets and liabilities exist at the balance-sheet date and that the recorded amounts represent transactions that occurred during the accounting period.
- *Completeness.* Confirm that all transactions and accounts that should be presented are included.
- *Rights and obligations.* Confirm that assets properly represent rights owned by the client and liabilities represent obligations of the client.
- *Valuation and allocation.* Confirm that all accounts are valued in accordance with GAAP.
- *Presentation and disclosure.* Confirm that accounts and related information are properly classified, described, and disclosed.

Therefore, before making an inquiry, you should see the relationship of the inquiry to the type of assertion that is included in the financial statements. After all, the purpose of the review engagement is to provide limited assurance concerning the presentation of the financial statements in accordance with GAAP.

## **OTHER REVIEW PROCEDURES**

Once the inquiries and analytical procedures are performed, you should be familiar with the client and its operations to truly understand the financial statements.

SSARS No. 1 states that you should read the financial statements to “consider, on the basis of information coming to the accountant’s attention, whether the financial statements appear to conform with generally accepted accounting principles.” You must use experience and professional judgment to assimilate the information you obtain, and you should read the financial statements in the context of that information.

Although there is no set process to follow in determining whether the financial statements conform with GAAP, the following steps illustrate one possible approach:

- As to industry and client accounting principles, consider the following:

- Does it appear that the client has applied accounting principles used by the industry in preparing its financial statements?
  - Does it appear that the client’s business transactions are consistent with the industry transactions?
  - Are unique industry accounting principles adequately described in the summary of significant accounting policies?
  - Does it appear that the client has applied other accounting principles properly in preparing the financial statements?
  - If accounting principles were not applied on a consistent basis, do the financial statements appear to reflect the appropriate disclosures and adjustments?
  - Do the client’s accounts on the financial statements appear consistent with the client’s operating characteristics?
- As to the accounting system and related procedures, consider the following:
    - Do the accounting procedures for recording, classifying, and summarizing transactions appear to provide a basis for the actual accounts and disclosures contained in the financial statements?
    - Have changes in the client’s business activities affected the accounting system, and does it appear that the resulting changes in transactions and accounts have been properly reflected in the financial statements?
  - Regarding other matters, consider the following:
    - Do the financial statements appear to properly reflect actions taken by the stockholders, board of directors, and other committees?
    - Do the financial statements appear to properly reflect events and transactions that occurred after the end of the accounting period but before completion of the review engagement?

In addition to the other review procedures just described, you should perform a technical reading of the financial statements. Although there is no complete list of questions that could be raised during a technical reading of the financial statements, the following are examples of the types of question that should be considered as part of the process:

- Regarding the form of the financial statements, consider the following:
  - Are headings on the financial statements appropriate according to the basis of accounting used to prepare the financial statements?
  - Are major sections of the financial statements properly captioned (such as the use of *current* and *noncurrent* captions on a classified balance sheet)?

- Are accounts grouped in appropriate captions (such as land held for investment classified as *other assets*)?
- On the basis of titles of transactions, are such transactions properly classified? (For example, is the gain on the sale of property, plant, and equipment classified properly on the income statement?)
- Regarding whether the statements are free from obvious material errors, consider the following:
  - Are there arithmetical errors in the financial statements (such as subtotals and totals)?
  - Are there clerical mistakes in the financial statements (such as typographical errors)?
  - Are there mistakes in the application of GAAP (such as the reporting of property, plant, and equipment at cost with no accumulated depreciation reported)?
  - Are financial statement disclosures omitted? (For example, is the method used to account for inventories omitted?)

The reading of the financial statements is an opportunity to determine whether those financial statements, in a broad sense, reflect the limited evidential matter you obtained in the review engagement.

The client's financial statements may include an accounting for all significant components, its subsidiaries, and other investees. If other accountants are engaged to audit or review the financial statements of such components, SSARS No. 1 requires you to obtain reports from other accountants as a basis, in part, for your review report with respect to the review of the financial statements of the client. If you decide to make reference to the work of the other accountants in your review report, the magnitude of the portion of the financial statements audited or reviewed by other accountants should be included in your report.

## **MANAGEMENT REPRESENTATIONS**

Written representations are required from management for all financial statements and periods covered by the accountant's review report. For example, if comparative financial statements are reported on, the representations obtained at the completion of the most recent review should address all periods being reported on. The specific written representations obtained by the accountant will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. SSARS No. 1 requires the following specific representations from management:

- Management's acknowledgment of its responsibility for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with GAAP
- Management's belief that the financial statements are fairly presented in conformity with GAAP

- Management’s full and truthful response to all inquiries
- Completeness of information
- Information concerning subsequent events

In addition, SSARS No. 10 adds the following specific management representation requirements related to fraud:

- Management’s acknowledgment of its responsibility to prevent and detect fraud
- Knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others



**Practice Pointer.** If the current management was not present during all periods covered by your review report, you should nevertheless obtain written representations from current management on all such periods.

The written representations should be addressed to the accountant and should be dated no earlier than the date of your review report. The letter should be signed by those members of management whom you believe are responsible for and knowledgeable about the matters covered in the representation letter. Normally, the chief executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter.

## **DOCUMENTATION**

Documentation is the principal record of the review procedures performed and the conclusions reached in performing the review. SSARS No. 1 states:

The accountant should prepare documentation in connection with a review of financial statements, the form and content of which should be designed to meet the circumstances of the particular engagement.

Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation you should prepare. However, SSARS No. 1 states that

The documentation should include any findings or issues that in the accountant’s judgment are significant, for example, the results of review procedures that indicate that the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached.

According to SSARS No. 1, the documentation of the review engagement should include the following:

- The matters covered in your inquiries

- The analytical procedures performed
- The expectations discussed above, where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in their development
- Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts
- Any additional procedures performed in response to significant unexpected differences arising from the analytical procedures and the results of such procedures
- Unusual matters that you considered during the performance of the review procedures, including their disposition
- The management representation letter

In addition to these required items, documentation of the review engagement might also include:

- A copy of the engagement letter
- A working trial balance with supporting schedules
- Review program with appropriate notation that procedures required by SSARS were performed
- Checklists for performing review procedures
- Memoranda summarizing conclusions with respect to the review of the financial statements or providing information to support footnotes
- Written memo or communication with predecessor CPA (if applicable)

Keep in mind, too, that you are not precluded from supporting your review report by other means. For example, written documentation from other engagements (such as compilation or consulting engagements) may be used to support your review report. In limited situations, oral explanations may provide support. However, oral explanations should be limited to those situations in which you find it necessary to supplement or clarify information contained in the working papers. Oral explanations should not be the principal support for the work performed or the conclusions reached.

## **SSARS HIERARCHY AND TECHNICAL CORRECTION**

SSARS No. 11 (AICPA, *Professional Standards*, vol. 2, AR sec. 50) establishes a SSARS hierarchy. The Statement is beneficial to practitioners by making them aware of the appropriate literature and the various publications' standing in the SSARS hierarchy. The hierarchy is as described in the following sections.



## **Level 1—Statements on Standards for Accounting and Review Services**

The ARSC develops and issues standards in the form of SSARS through a due process that includes deliberations in meetings open to the public, public exposure of proposed SSARS, and a formal vote. The SSARS are codified. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her engagement. The nature of the SSARS requires an accountant to exercise professional judgment in applying them. The accountant should be prepared to justify departures from the SSARS.

## **Level 2—Interpretative Publications**

Interpretative publications consist of compilation and review Interpretations of the SSARS and appendixes to the SSARS, compilation and review guidance included in AICPA Audit and Accounting Guides, and AICPA Statements of Position (SOPs), to the extent that those SOPs are applicable to compilation and review engagements. Interpretative publications are not standards for accounting and review services. Interpretative publications are recommendations on the application of the SSARS in specific circumstances, including engagements for entities in specialized industries. Interpretative publications are included in the *Codification of Statements on Standards for Accounting and Review Services*. An interpretative publication is issued after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretative publication is consistent with the SSARS. The accountant should be aware of and consider interpretive publications applicable to his or her compilation or review. If the accountant does not apply the guidance included in an applicable interpretive publication, the accountant should be prepared to explain how he or she complied with the SSARS provisions addressed by such guidance.

## **Level 3—Other Publications**

Other compilation and review publications include AICPA accounting and review publications not referred to above; AICPA's annual *Compilation and Review Alert*; compilation and review articles in the *Journal of Accountancy* and other professional journals; compilation and review articles in the *AICPA CPA Letter*; continuing professional education (CPE) programs and other instruction materials, textbooks, guide books, compilation and review programs, and checklists; and other compilation and review publications from state CPA societies, other organizations, and individuals. Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply the SSARS. If an accountant applies the guidance included in an other compilation and review publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the engagement, and appropriate. In determining whether an other compilation and review publication is appropriate, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying

the SSARS and the degree to which the issuer or author is recognized as an authority in compilation and review matters. Other compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate.

### **Technical Correction**

In addition, SSARS No. 11 addresses a technical correction to SSARS No. 2, *Reporting on Comparative Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 200). SSARS currently provide guidance to be followed when the financial statements of a prior period have been compiled or reviewed by a predecessor accountant whose report is not presented and the successor accountant has not compiled or reviewed those prior period financial statements. This Statement revises SSARS No. 2 to conform with the guidance found in SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508), as amended, which states that a successor auditor may name the predecessor auditor if the predecessor auditor's practice was acquired by, or merged with, that of the successor auditor.

## **IMPLEMENTATION QUESTIONS AND ANSWERS**

These Q&As have been included to concisely cover some of the most frequently asked questions about SSARS No. 10.

1. *What is the objective of performing analytical procedures in a review engagement?*

In a review, the objectives of analytical procedures are to:

- Provide a basis for the limited assurance provided in the review report.
- Identify financial statement items that appear to be materially misstated.

2. *What are the differences between analytical procedures performed for an audit and for a review engagement?*

There is a subtle difference between analytical procedures performed for an audit engagement and a review engagement. This difference is based on the desired level of assurance. In an audit, the analytical procedures are designed to provide reasonable assurance that the financial statements are fairly presented. In a review, they are performed in connection with inquiries of management to provide limited assurance that you are not aware of any material misstatements.

3. *Do I have to follow the guidance on analytical procedures contained in SAS No. 56, Analytical Procedures (AICPA, Professional Standards, vol. 1, AU sec. 329)?*

No. Requirements in SASs apply to compilation and review engagements only if a SSARS or a SSARS Interpretation explicitly cites the SAS as a requirement. However, there may be

situations in which it is useful to refer to a SAS, and in several instances, SSARS and SSARS Interpretations suggest but do not require that you consider the guidance in a particular SAS.

4. *What should I do if I find a significant unexpected fluctuation or unusual relationship as a result of the analytical procedures?*

If the assumed error is material or approaches the materiality threshold, you should consider additional investigation, including making inquiries, performing other analytical procedures, and performing nonanalytical procedures, such as recomputing information.

5. *If I perform additional procedures, such as the confirmation of receivables and observation of inventories, in connection with a review engagement, do I have to change the engagement to an audit?*

No. SSARS makes it clear that the standards for performing compilations or reviews of financial statements do not preclude you from performing any procedures that you deem necessary or that the client requests. However, you should have a clear understanding with the client regarding the services to be performed (preferably in writing).

6. *What should I do if, during the performance of a review engagement, I suspect that fraud or an illegal act may have occurred?*

SSARS No. 1, AR sec. 100.05, states that the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should provide that the accountant will inform the appropriate level of management of any material errors that come to his or her attention, unless they are clearly inconsequential. Whenever you suspect that fraud or an illegal act may have occurred, you should communicate that matter, unless it is clearly inconsequential, to the appropriate level of management. When the suspected fraud or illegal act involves senior management, you should communicate the matter to an individual or group at the highest level within the entity, such as the manager (owner) or the board of directors. If the fraud or illegal act involves an owner of the business, you should consider withdrawing from the engagement. You need not perform additional procedures to ascertain whether fraud, in fact, occurred or the probability that fraud occurred. However, you should consider the impact of the suspected matter on your ability to perform inquiries and other review procedures such as obtaining a management representation letter.



**Practice Pointer.** If the fraud or illegal act extends to prior period financial statements, Interpretation No. 4, “Discovery of Information After the Date of the Accountant’s Report,” of SSARS No. 1 (AICPA, *Professional Standards*, vol. 2, AR sec. 9100.04), states that, in determining the appropriate course of action, you should consider (1) the reliability of the information that has come to your attention and (2) the existence of persons known to be relying on the financial statements.

7. *If I perform other services for the client (bookkeeping, payroll, income tax, etc.), may I use the information obtained from these services to reduce the amount of inquiries and analytical procedures in a review of the client's financial statements?*

Yes. You may obtain information from a variety of accounting services. SSARS No. 1 states that knowledge acquired in the performance of audits of the client's financial statements, compilation of the financial statements, or other accounting services may result in the modification of the inquiries and analytical procedures.

8. *How will I know when I have enough information in a review engagement?*

This is strictly a matter of professional judgment. Most accountants have a standard set of inquiries and analytical procedures that are a starting point for every engagement. This standard set is modified based on economic, industry, and client characteristics. The engagement is complete when you have obtained a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements.

## **APPENDIX A: ANALYTICAL PROCEDURES THE ACCOUNTANT MAY CONSIDER PERFORMING WHEN CONDUCTING A REVIEW OF FINANCIAL STATEMENTS\***

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the financial statements. The analytical procedures performed in a review of financial statements are a matter of the accountant's professional judgment. In determining the appropriate analytical procedures, an accountant may consider (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data.

The following list of analytical procedures is for illustrative purposes only. These analytical procedures will not necessarily be applicable in every review engagement, nor are these analytical procedures meant to be all-inclusive. These illustrative analytical procedures are not intended to serve as a program or checklist to be utilized in performing a review engagement. Examples of analytical procedures an accountant may consider performing in a review of financial statements include:

- Comparing financial statements with statements for comparable prior period(s).
- Comparing current financial information with anticipated results, such as budgets or forecasts (for example, comparing tax balances and the relationship between the provision for income taxes and pretax income in the current financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods).<sup>1</sup>
- Comparing current financial information with relevant nonfinancial information.

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\*Source: Appendix H of Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.68), as amended.

<sup>1</sup>The accountant should exercise caution when comparing and evaluating current financial information with budgets, forecasts, or other anticipated results because of the inherent lack of precision in estimating the future and the susceptibility of such information to manipulation and misstatement by management to reflect desired results.

- Comparing ratios and indicators for the current period with expectations based on prior periods, for example, performing gross profit analysis by product line and operating segment using elements of the current financial information and comparing the results with corresponding information for prior periods. Examples of key ratios and indicators are the current ratio, receivable turnover or days' sales outstanding, inventory turnover, depreciation to average fixed assets, debt to equity, gross profit percentage, net income percentage, and plant operating rates.
- Comparing ratios and indicators for the current period with those of entities in the same industry.
- Comparing relationships among elements in the current financial information with corresponding relationships in the financial information of prior periods, for example, expense by type as a percentage of sales, assets by type as a percentage of total assets, and percentage of change in sales to percentage of change in receivables.

Analytical procedures may include such statistical techniques as trend analysis or regression analysis and may be performed manually or with the use of computer-assisted techniques.

In addition, the accountant may find the guidance in SAS No. 56, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 329), as amended, useful in conducting a review of financial statements.

## **APPENDIX B: REVIEW OF FINANCIAL STATEMENTS—ILLUSTRATIVE INQUIRIES\***

The inquiries to be made in a review of financial statements are a matter of the accountant's professional judgment. In determining the appropriate inquiries, an accountant may consider (a) the nature and materiality of the items reflected in the financial statements, (b) the likelihood of a misstatement in the financial statements, (c) knowledge obtained during current and previous engagements, (d) the stated qualifications of the entity's accounting personnel, (e) the extent to which a particular item is affected by management's judgment, and (f) inadequacies in the entity's underlying financial data. The inquiries should generally be made of members of management with financial reporting and accounting responsibilities.

The following list of inquiries is for illustrative purposes only. These inquiries will not necessarily be applicable in every review engagement, nor are these inquiries meant to be all-inclusive. These illustrative inquiries are not intended to serve as a program or checklist to be utilized in performing a review engagement; rather, they address general areas where inquiries might be made in a review engagement. Also, the accountant may feel it necessary to make several inquiries in an effort to answer questions related to the issues addressed in these illustrative inquiries.

### 1. General

- a. Have there been any changes in the entity's business activities?
- b. Are there any unusual or complex situations that may have an effect on the financial statements (for example, business combinations, restructuring plans, or litigation)?
- c. What procedures are in place related to recording, classifying, and summarizing transactions and accumulating information related to financial statement disclosures?
- d. Have the financial statements been prepared in conformity with generally accepted accounting principles or, if appropriate, a comprehensive basis of accounting other than generally accepted accounting principles? Have there been any changes in accounting principles and methods of applying those principles?
- e. Have there been any instances of fraud or illegal acts within the entity?
- f. Have there been any allegations or suspicions that fraud or illegal acts might have occurred or might be occurring within the entity? If so, where and how?

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\*Source: Appendix B of Statement on Standards for Accounting and Review Services No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.62), as amended.

- g. Are any entities, other than the reporting entity, commonly controlled by the owners? If so, has an evaluation been performed to determine whether those other entities should be consolidated into the financial statements of the reporting entity?
- h. Are there any entities other than the reporting entity in which the owners have significant investments (for example, variable interest entities)? If so, has an evaluation been performed to determine whether the reporting entity is the primary beneficiary related to the activities of these other entities?
- i. Have any significant transactions occurred or been recognized near the end of the reporting period?

## 2. Cash and Cash Equivalents

- a. Is the entity's policy regarding the composition of cash and cash equivalents in accordance with Financial Accounting Standards Board Statement of Financial Accounting Standards No. 95, *Statement of Cash Flows* (paragraphs 7–10)? Has the policy been applied on a consistent basis?
- b. Are all cash and cash equivalents<sup>1</sup> accounts reconciled on a timely basis?
- c. Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made where necessary?
- d. Has there been a proper cutoff of cash receipts and disbursements?
- e. Has a reconciliation of intercompany transfers been prepared?
- f. Have checks written but not mailed as of the financial statement date been properly reclassified into the liability section of the balance sheet?
- g. Have material bank overdrafts been properly reclassified into the liability section of the balance sheet?
- h. Are there compensating balances or other restrictions on the availability of cash balances? If so, has consideration been given to reclassifying these amounts as noncurrent assets?
- i. Have cash funds been counted and reconciled with control accounts?

## 3. Receivables

- a. Has an adequate allowance for doubtful accounts been properly reflected in the financial statements?

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<sup>1</sup> Cash and cash equivalents include all cash and highly liquid investments that are both (a) readily convertible to cash and (b) so near to maturity that they present insignificant risk of changes in value because of changes in interest rates, in accordance with paragraph 8 of Financial Accounting Standards Board Statement No. 95, *Statement of Cash Flows*.



- b.* Have uncollectible receivables been written off through a charge against the allowance account or earnings?
- c.* Has interest earned on receivables been properly reflected in the financial statements?
- d.* Has there been a proper cutoff of sales transactions?
- e.* Are there receivables from employees or other related parties? Have receivables from owners been evaluated to determine if they should be reflected in the equity section (rather than the asset section) of the balance sheet?
- f.* Are any receivables pledged, discounted, or factored? Are recourse provisions properly reflected in the financial statements?
- g.* Have receivables been properly classified between current and noncurrent?
- h.* Have there been significant numbers of sales returns or credit memoranda issued subsequent to the balance sheet date?
- i.* Is the accounts receivable subsidiary ledger reconciled to the general ledger account balance on a regular basis?

#### 4. Inventory

- a.* Are physical inventory counts performed on a regular basis, including at the end of the reporting period? Are the count procedures adequate to ensure an appropriate count? If not, how have amounts related to inventories been determined for purposes of financial statement presentation? If so, what procedures were used to take the latest physical inventory and what date was that inventory taken?
- b.* Have general ledger control accounts been adjusted to agree with the physical inventory count? If so, were the adjustments significant?
- c.* If the physical inventory counts were taken at a date other than the balance sheet date, what procedures were used to determine changes in inventory between the date of the physical inventory counts and the balance sheet date?
- d.* Were consignments in or out considered in taking physical inventories?
- e.* What is the basis of valuing inventory for purposes of financial statement presentation?
- f.* Does inventory cost include material, labor, and overhead where applicable?
- g.* Has inventory been reviewed for obsolescence or cost in excess of net realizable value? If so, how are these costs reflected in the financial statements?
- h.* Have proper cutoffs of purchases, goods in transit, and returned goods been made?

- i.* Are there any inventory encumbrances?
- j.* Is scrap inventoried and controlled?

5. Prepaid Expenses

- a.* What is the nature of the amounts included in prepaid expenses?
- b.* How are these amounts being amortized?

6. Investments

- a.* What is the basis of accounting for investments reported in the financial statements (for example, securities, joint ventures, or closely-held businesses)?
- b.* Are derivative instruments properly measured and disclosed in the financial statements? If those derivatives are utilized in hedge transactions, have the documentation or assessment requirements related to hedge accounting been met?
- c.* Are investments in marketable debt and equity securities properly classified as trading, available-for-sale, and held-to-maturity?
- d.* How were fair values of the reported investments determined? Have unrealized gains and losses been properly reported in the financial statements?
- e.* If the fair values of marketable debt and equity securities are less than cost, have the declines in value been evaluated to determine whether the declines are other-than-temporary?
- f.* For any debt securities classified as held-to-maturity, does management have the positive ability and intent to hold the securities until they mature? If so, have those debt securities been properly measured?
- g.* Have gains and losses related to disposal of investments been properly reflected in the financial statements?
- h.* How was investment income determined? Is investment income properly reflected in the financial statements?
- i.* Has appropriate consideration been given to the classification of investments between current and noncurrent?
- j.* For investments made by the reporting entity, have consolidation, equity, or cost method accounting requirements been considered?
- k.* Are any investments encumbered?

7. Property and Equipment

- a.* Are property and equipment items properly stated at depreciated cost or other proper value?

- b.* When was the last time a physical inventory of property and equipment was taken?
  - c.* Are all items reflected in property and equipment held for use? If not, have items that are held for sale been properly reclassified from property and equipment?
  - d.* Have gains or losses on disposal of property and equipment been properly reflected in the financial statements?
  - e.* What are the criteria for capitalization of property and equipment? Have the criteria been consistently and appropriately applied?
  - f.* Are repairs and maintenance costs properly reflected as an expense in the income statement?
  - g.* What depreciation methods and rates are utilized in the financial statements? Are these methods and rates appropriate and applied on a consistent basis?
  - h.* Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?
  - i.* Does the entity have any material lease agreements? If so, have those agreements been properly evaluated for financial statement presentation purposes?
  - j.* Are there any asset retirement obligations associated with tangible long-lived assets? If so, has the recorded amount of the related asset been increased because of the obligation and is the liability properly reflected in the liability section of the balance sheet?
  - k.* Has the entity constructed any of its property and equipment items? If so, have all components of cost been reflected in measuring these items for purposes of financial statement presentation, including, but not limited to, capitalized interest?
  - l.* Has there been any significant impairment in value of property and equipment items? If so, has any impairment loss been properly reflected in the financial statements?
  - m.* Are any property and equipment items mortgaged or otherwise encumbered? If so, are these mortgages and encumbrances properly reflected in the financial statements?
8. Intangibles and Other Assets
- a.* What is the nature of the amounts included in other assets?
  - b.* Do these assets represent costs that will benefit future periods? What is the amortization policy related to these assets? Is this policy appropriate?
  - c.* Have other assets been properly classified between current and noncurrent?
  - d.* Are intangible assets with finite lives being appropriately amortized?
  - e.* Are the costs associated with computer software properly reflected as intangible assets (rather than property and equipment) in the financial statements?

- f.* Are the costs associated with goodwill (and other intangible assets with indefinite lives) properly reflected as intangible assets in the financial statements? Has amortization been ceased related to these assets?
  - g.* Has there been any significant impairment in value of these assets? If so, has any impairment loss been properly reflected in the financial statements?
  - h.* Are any of these assets mortgaged or otherwise encumbered?
9. Accounts and Short-Term Notes Payable and Accrued Liabilities
- a.* Have significant payables been reflected in the financial statements?
  - b.* Are loans from financial institutions and other short-term liabilities properly classified in the financial statements?
  - c.* Have significant accruals (for example, payroll, interest, provisions for pension and profit-sharing plans, or other postretirement benefit obligations) been properly reflected in the financial statements?
  - d.* Has a liability for employees' compensation for future absences been properly accrued and disclosed in the financial statements?
  - e.* Are any liabilities collateralized or subordinated? If so, are those liabilities disclosed in the financial statements?
  - f.* Are there any payables to employees and related parties?
10. Long-Term Liabilities
- a.* Are the terms and other provisions of long-term liability agreements properly disclosed in the financial statements?
  - b.* Have liabilities been properly classified between current and noncurrent?
  - c.* Has interest expense been properly accrued and reflected in the financial statements?
  - d.* Is the company in compliance with loan covenants and agreements? If not, is the noncompliance properly disclosed in the financial statements?
  - e.* Are any long-term liabilities collateralized or subordinated? If so, are these facts disclosed in the financial statements?
  - f.* Are there any obligations that, by their terms, are due on demand within one year from the balance sheet date? If so, have these obligations been properly reclassified into the current liability section of the balance sheet?

11. Income and Other Taxes

- a. Do the financial statements reflect an appropriate provision for current and prior-year income taxes payable?
- b. Have any assessments or reassessments been received? Are there tax authority examinations in process?
- c. Are there any temporary differences between book and tax amounts? If so, have deferred taxes on these differences been properly reflected in the financial statements?
- d. Do the financial statements reflect an appropriate provision for taxes other than income taxes (for example, franchise, sales)?
- e. Have all required tax payments been made on a timely basis?

12. Other Liabilities, Contingencies, and Commitments

- a. What is the nature of the amounts included in other liabilities?
- b. Have other liabilities been properly classified between current and noncurrent?
- c. Are there any guarantees, whether written or verbal, whereby the entity must stand ready to perform or is contingently liable related to the guarantee? If so, are these guarantees properly reflected in the financial statements?
- d. Are there any contingent liabilities (for example, discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims)? Are there any potential unasserted claims? Are these contingent liabilities, claims, and assessments properly measured and disclosed in the financial statements?
- e. Are there any material contractual obligations for construction or purchase of property and equipment or any commitments or options to purchase or sell company securities? If so, are these facts clearly disclosed in the financial statements?
- f. Is the entity responsible for any environmental remediation liability? If so, is this liability properly measured and disclosed in the financial statements?
- g. Does the entity have any agreement to repurchase items that previously were sold? If so, have the repurchase agreements been taken into account in determining the appropriate measurements and disclosures in the financial statements?
- h. Does the entity have any sales commitments at prices expected to result in a loss at the consummation of the sale? If so, are these commitments properly reflected in the financial statements?
- i. Are there any violations, or possible violations, of laws or regulations the effects of which should be considered for financial statement accrual or disclosure?

### 13. Equity

- a. What is the nature of any changes in equity accounts during each reporting period?
- b. What classes of stock (other ownership interests) have been authorized?
- c. What is the par or stated value of the various classes of stock (other ownership interests)?
- d. Do amounts of outstanding shares of stock (other ownership interests) agree with subsidiary records?
- e. Have pertinent rights and privileges of ownership interests been properly disclosed in the financial statements?
- f. Does the entity have any mandatorily redeemable ownership interests? If so, have these ownership interests been evaluated so that a proper determination has been made related to whether these ownership interests should be measured and reclassified to the liability section of the balance sheet? Are redemption features associated with ownership interests clearly disclosed in the financial statements?
- g. Have dividend (distribution) and liquidation preferences related to ownership interests been properly disclosed in the financial statements?
- h. Do disclosures related to ownership interests include any applicable call provisions (prices and dates), conversion provisions (prices and rates), unusual voting rights, significant terms of contracts to issue additional ownership interests, or any other unusual features associated with the ownership interests?
- i. Are syndication fees properly reflected in the financial statements as a reduction of equity (rather than an asset)?
- j. Have any stock options or other stock compensation awards been granted to employees or others? If so, are these options or awards properly measured and disclosed in the financial statements?
- k. Has the entity made any acquisitions of its own stock? If so, are the amounts associated with these reacquired shares properly reflected in the financial statements as a reduction in equity? Is the presentation in accordance with applicable state laws?
- l. Are there any restrictions or appropriations on retained earnings or other capital accounts? If so, are these restrictions or appropriations properly reflected in the financial statements?

### 14. Revenue and Expenses

- a. What is the entity's revenue recognition policy? Is the policy appropriate? Has the policy been consistently applied and appropriately disclosed?

- b.* Are revenues from sales of products and rendering of services recognized in the appropriate reporting period (that is, when the products have been delivered and when the services have been performed)?
- c.* Were any sales recorded under a “bill and hold” arrangement? If yes, have the criteria been met to record the transaction as a sale?
- d.* Are purchases and expenses recognized in the appropriate reporting period (that is, matched against revenue) and properly classified in the financial statements?
- e.* Do the financial statements include discontinued operations, or items that might be considered extraordinary, or both? If so, are amounts associated with discontinued operations, extraordinary items, or both properly displayed in the income statement?
- f.* Does the entity have any gains or losses that would necessitate the display of comprehensive income (for example, gains/losses on available-for-sale securities or cash flow hedge derivatives)? If so, have these items been properly displayed within comprehensive income (rather than included in the determination of net income)?

15. Other

- a.* Have events occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements?
- b.* Have actions taken at stockholders, directors, committees of directors, or comparable meetings that affect the financial statements been reflected in the financial statements?
- c.* Are significant estimates and material concentrations (for example, customers or suppliers) properly disclosed in the financial statements?
- d.* Are there plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities reflected in the financial statements?
- e.* Have there been material transactions between or among related parties (for example, sales, purchases, loans, or leasing arrangements)? If so, are these transactions properly disclosed in the financial statements?
- f.* Are there uncertainties that could have a material impact on the financial statements? Is there any change in the status of previously disclosed material uncertainties? Are all uncertainties, including going concern matters that could have a material impact on the financial statements properly disclosed in the financial statements?
- g.* Are barter or other nonmonetary transactions properly recorded and disclosed?





# **APPENDIX C: SSARS INTERPRETATION NO. 26, “COMMUNICATING POSSIBLE FRAUD AND ILLEGAL ACTS TO MANAGEMENT AND OTHERS”**

*Interpretations are issued to provide guidance on the application of Statements on Standards for Accounting and Review Services (SSARS). Interpretations are issued after all members of the AICPA Accounting and Review Services Committee (ARSC) have been provided an opportunity to consider and comment on whether the proposed Interpretation is consistent with SSARS. An Interpretation is not as authoritative as a SSARS, but members should be aware that they may have to justify a departure from an Interpretation if the quality of their work is questioned.*

## **AR Section 9100**

### **Compilation and Review of Financial Statements: Accounting and Review Services Interpretations of Section 100**

#### **26. Communicating Possible Fraud and Illegal Acts to Management and Others**

**.100 Question**—Paragraph 5 of SSARS No. 1 [section 100.05], *Compilation and Review of Financial Statements*, states that the accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed. The understanding should provide that the accountant will inform the appropriate level of management of any material errors that come to his or her attention and any fraud or illegal acts that come to his or her attention, unless they are clearly inconsequential. When, during the performance of a compilation or a review engagement, the accountant suspects that a fraud or an illegal act may have occurred, what steps should be taken in performing the required communication?

**.101 Interpretation**—When an accountant suspects that a fraud or an illegal act may have occurred,<sup>13</sup> the accountant communicates the matter, unless clearly inconsequential, to an appropriate level of management. If the suspected fraud or illegal act involves senior management, the matter should be communicated to an individual or group at the highest level within the entity, such as the manager (owner) or the board of directors. When the suspected fraud or illegal act involves an owner of the business, the accountant should consider resigning from the engagement.<sup>14</sup> Additionally, the accountant should consider consulting with his or her legal counsel and insurance provider whenever fraud or an illegal act is suspected.

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<sup>13</sup> If the suspected fraud or illegal act extends to prior period financial statements, see Interpretation No. 4, “Discovery of Information After the Date of the Accountant’s Report” [section 9100.13–.15].

<sup>14</sup> See Interpretation No. 6, “Withdrawal From Compilation or Review Engagement” [section 9100.18–.22], for guidance as to the circumstances under which the accountant would ordinarily conclude that it is necessary to withdraw from a compilation or review engagement.

**.102** The accountant need not perform additional procedures to ascertain whether fraud or an illegal act, in fact, occurred or the probability that fraud or an illegal act occurred. However, the accountant should consider the impact of the suspected matter on the accountant's ability to perform inquiries and other review procedures such as obtaining a management representation letter and keep in mind that the purpose of the review is to express limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles.

**.103** The disclosure of possible fraud or illegal act to parties other than the client's senior management ordinarily is not part of the accountant's responsibility and ordinarily would be precluded by the accountant's ethical or legal obligations of confidentiality. The accountant should recognize, however, that in the following circumstances a duty to disclose to parties outside of the entity may exist:

- a. To comply with certain legal and regulatory requirements
- b. To a successor accountant when the successor decides to communicate with the predecessor accountant in accordance with SSARS No. 4, *Communications Between Predecessor and Successor Accountants* [section 400], regarding acceptance of an engagement to compile or review the financial statements of a nonpublic entity
- c. In response to a subpoena

Because potential conflicts between the accountant's ethical and legal obligations for confidentiality of client matters may be complex, the accountant may wish to consult with legal counsel before discussing such matters with parties outside the client.

[Issue Date: May, 2004.]

## **APPENDIX D: STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES NO. 10, PERFORMANCE OF REVIEW ENGAGEMENTS\***

1. Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements* (AICPA, *Professional Standards*, vol. 2, AR sec. 100.24–.33), currently provides guidance on analytical procedures, inquiries, and other procedures applicable to a review of financial statements whether prepared under generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles. This Statement amends SSARS No. 1 (AR sec. 100.24–.33) to expand on previous guidance on analytical procedures, inquiries, and other review procedures; to provide inquiries regarding fraud in a review engagement and to require representations regarding fraud in the management representation letter; and to clarify and provide guidance regarding workpaper documentation in a review engagement. New language is shown in boldface italics; deleted language is shown by strikethrough. Subsequent paragraphs will be renumbered accordingly.

### **Review of Financial Statements**

~~.24~~ Paragraphs ~~.25~~ through ~~.40.44~~ provide additional guidance applicable to a review of financial statements. ***Procedures for conducting a review of financial statements generally are limited to analytical procedures and inquiries. The accountant performs these procedures to obtain a basis for communicating whether he or she is aware of any material modifications that should be made to the financial statements for them to be in conformity with generally accepted accounting principles. The specific inquiries made and the analytical and other procedures performed should be tailored to the engagement based on the accountant's knowledge of the entity's business. For example, if the accountant becomes aware of a significant change in the entity's operations, the accountant may consider making additional inquiries, employing additional analytical procedures, or both.***

~~.25~~~~2~~ A review does not contemplate obtaining an understanding of internal control or assessing control risk, tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, and certain other procedures ordinarily performed during an audit. Thus, a review does not provide assurance that the accountant will become aware of all significant matters that would

be disclosed in an audit. However, if the accountant becomes aware that information coming to his **or her** attention is incorrect, incomplete, or otherwise unsatisfactory, ~~he~~ **the accountant** should perform the additional procedures ~~he~~ **deems** necessary to achieve limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with generally accepted accounting principles. (See paragraph ~~38.42~~ for guidance when an accountant is unable to complete a review and paragraphs ~~41.45~~ through ~~43.47~~ for the accountant's responsibilities when he **or she** is aware of departures from generally accepted accounting principles.)

**Knowledge of Accounting Principles and Practices of the Industry**

~~.2625~~ The accountant should possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates and an understanding of the entity's business<sup>17</sup> that will provide ~~him~~, 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 in order for the statements to be in conformity with generally accepted accounting principles. (As previously noted, reference to generally accepted accounting principles in this ~~s~~Statement includes, where applicable, ~~another~~ **an other** comprehensive basis of accounting.)

~~.2726~~ The requirement that the accountant possess a level of knowledge of the accounting principles and practices of the industry in which the entity operates does not prevent an accountant from accepting a review engagement for an entity in an industry with which the accountant has no previous experience. It does, however, place upon the accountant a responsibility to obtain the required level of knowledge. The accountant may do so, for example, by consulting AICPA guides, industry publications, financial statements of other entities in the industry, textbooks and periodicals, or individuals knowledgeable about the industry.

~~.2827~~ The accountant's understanding of the entity's business should include a general understanding of the entity's organization, its operating characteristics, and the nature of its assets, liabilities, revenues, and expenses. This would ordinarily involve a general knowledge of the entity's production, distribution, and compensation methods, types of products and services, operating locations,

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17. For purposes of this ~~s~~Statement, the term *business* includes not-for-profit entities.

and material transactions with related parties. An accountant's understanding of an entity's business is ordinarily obtained through experience with the entity or its industry and inquiry of the entity's personnel.

### **Analytical Procedures**

~~.2928 The accountant's inquiry and analytical procedures should ordinarily consist of the following:~~ **The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a material misstatement. Analytical procedures should include:**

- *Developing expectations by identifying and using plausible relationships that are reasonably expected to exist based on the accountant's understanding of the entity and the industry in which the entity operates.*
- *Comparing recorded amounts, or ratios developed from recorded amounts, to expectations developed by the accountant.*

*See Appendix H for examples of analytical procedures an accountant may consider performing when conducting a review of financial statements.*

*.30 Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit. Also, in a review the accountant ordinarily is not required to corroborate management's responses with other evidence. However, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business and the industry in which it operates.*

### **Inquiries and Other Review Procedures**

*.31 The following are inquiries the accountant should consider making and other review procedures the accountant should consider performing when conducting a review of financial statements:*

- ~~a. Inquiries concerning the entity's accounting principles and practices and the methods followed in applying them (see Appendix B [paragraph .58]).~~ **Inquiries to members of management who**

*have responsibility for financial and accounting matters concerning (see Appendix B):*

- (1) Whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied.*
  - (2) The entity's accounting principles and practices and the methods followed in applying them and procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements.*
  - (3) Unusual or complex situations that may have an effect on the financial statements.*
  - (4) Significant transactions occurring or recognized near the end of the reporting period.*
  - (5) The status of uncorrected misstatements identified during the previous engagement.*
  - (6) Questions that have arisen in the course of applying the review procedures.*
  - (7) Events subsequent to the date of the financial statements that could have a material effect on the financial statements.*
  - (8) Their knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, for example, communications received from employees, former employees, or others.*
  - (9) Significant journal entries and other adjustments.*
  - (10) Communications from regulatory agencies.*
- b. Inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements (see Appendix B [paragraph .58]).*
- e. Analytical procedures designed to identify relationships and individual items that appear to be unusual. For the purposes of this statement, analytical procedures consist of (1) comparison of the financial statements with statements for comparable prior period(s), (2) comparison of the financial statements with anticipated results, if available (for example, budgets and forecasts), and (3) study of the relationships of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience. In applying these pro-*

cedures, the accountant should consider the types of matters that required accounting adjustments in preceding periods. Examples of relationships of elements in financial statements that would be expected to conform to a predictable pattern may be the relationships between changes in sales and changes in accounts receivable and expense accounts that ordinarily fluctuate with sales, and between changes in property, plant, and equipment and changes in depreciation expense and other accounts that may be affected, such as maintenance and repairs.

- ~~b~~**d**. Inquiries concerning actions taken at meetings of shareholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.
- ~~c~~**e**. Reading the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with generally accepted accounting principles.
- ~~d~~**f**. Obtaining reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees.<sup>18</sup>
- ~~e~~**g**. ~~Inquiries of persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied, (2) changes in the entity's business activities or accounting principles and practices, (3) matters as to which questions have arisen in the course of applying the foregoing procedures, and (4) events subsequent to the date of the financial statements that would have a material effect on the financial statements.~~

### **Management Representations**

~~.3229~~ Written representations are required from management for all financial statements and periods covered by the accountant's review report. For example, if comparative financial statements are

18. The financial statements of the reporting entity ordinarily include an accounting for all significant components, such as unconsolidated subsidiaries and investees. If other accountants are engaged to audit or review the financial statements of such components, the accountant will require reports from **the** other accountants as a basis, in part, for **his the accountant's review** report ~~on his~~ **with respect to the** review of the financial statements of the reporting entity. The accountant may decide to make reference to the work of other accountants in **his the accountant's** review report on the financial statements. If such reference is made, the report should indicate the magnitude of the portion of the financial statements audited or reviewed by the other accountants.

reported on, the representations obtained at the completion of the most recent review should address all periods being reported on. The specific written representations obtained by the accountant will depend on the circumstances of the engagement and the nature and basis of presentation of the financial statements. In connection with a review of financial statements presented in accordance with generally accepted accounting principles, specific representations should relate to the following matters:<sup>19</sup>

- a. Management's acknowledgment of its responsibility for the fair presentation in the financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles
- b. Management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles
- c. **Management's acknowledgment of its responsibility to prevent and detect fraud**
- d. **Knowledge of any fraud or suspected fraud affecting the entity involving management or others where the fraud could have a material effect on the financial statements, including any communications received from employees, former employees, or others**
- ee. Management's full and truthful response to all inquiries
- fd. Completeness of information
- ge. Information concerning subsequent events

The representation letter ordinarily should be tailored to include additional appropriate representations from management relating to matters specific to the entity's business or industry. An illustrative representation letter is presented in Appendix F.

~~.3330~~ The written representations should be addressed to the accountant. Because the accountant is concerned with events occurring through the date of the report that may require adjustment to or disclosure in the financial statements, the representations should be made as of a date no earlier than the date of the accountant's report. The letter should be signed by those members of management whom the accountant believes are responsible for and knowledgeable, directly or through others in the organization, about the matters covered in the representation letter. Normally, the chief

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19. Specific representations also are applicable to financial statements presented in conformity with a comprehensive basis of accounting other than generally accepted accounting principles. The specific representations to be obtained should be based on the nature and basis of presentation of the financial statements being reviewed.



executive officer and chief financial officer or others with equivalent positions in the entity should sign the representation letter. If the current management was not present during all periods covered by the accountant's report, the accountant should nevertheless obtain written representations from current management on all such periods.

~~.3431~~ Knowledge acquired in the performance of audits of the entity's financial statements, compilation of the financial statements, or other accounting services may result in modification of the review procedures described in paragraphs ~~.28.29 through~~ **.31**. However, such modification would not reduce the degree of responsibility the accountant assumes with respect to the **reviewed** financial statements ~~he has reviewed~~.

#### **Documentation in a Review Engagement**

**.35** *The accountant should prepare documentation in connection with a review of financial statements, the form and content of which should be designed to meet the circumstances of the particular engagement. Documentation is the principal record of the review procedures performed and the conclusions reached by the accountant in performing the review. However, an accountant would not be precluded from supporting his or her review report by other means in addition to the review documentation. Such other means might include written documentation contained in other engagement (for example compilation) files or quality control files (for example consultation files) and in limited situations, oral explanations. Oral explanations should be limited to those situations where the accountant finds it necessary to supplement or clarify information contained in the documentation. Oral explanations should not be the principal support for the work performed or the conclusions reached.*

~~.3633~~ **Because of the different circumstances in individual engagements,** ~~Although it is not possible to specify the form or content of the working papers that an~~ **documentation** ~~the accountant should prepare in connection with a review of financial statements because of the different circumstances of individual engagements, the accountant's working papers should describe.~~ **However, the documentation should include any findings or issues that in the accountant's judgment are significant, for example, the results of review procedures that indicate the financial statements could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached.**

**.37 The documentation of the inquiry and analytical procedures should include the following:**

- a. The matters covered in the accountant's inquiry ~~and analytical~~ procedures.
- b. The analytical procedures performed.**
- c. The expectations as discussed in paragraph .29, where significant expectations are not otherwise readily determinable from the documentation of the work performed, and factors considered in the development of those expectations.**
- d. Results of the comparison of the expectations to the recorded amounts or ratios developed from recorded amounts.**
- e. Any additional procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures.**
- fb.** Unusual matters that the accountant considered during the performance of the review **procedures**, including their disposition.
- g. The representation letter.**

2. This Standard is effective for reviews of financial statements for periods ending on or after December 15, 2004.

3. This Statement amends Appendix B to SSARS No. 1 and adds an additional appendix to SSARS No. 1 (Appendix H). New language is shown in boldface italics; deleted language is shown by strikethrough.

*[The amendments to Appendix B and addition of Appendix H referred to above have been omitted from this reprint of SSARS No. 10. Refer to Appendix A, "Analytical Procedures the Accountant May Consider Performing When Conducting a Review of Financial Statements," of this Practice Aid for a reprint of Appendix H to SSARS No. 1, as amended. Refer to Appendix B, "Review of Financial Statements—Illustrative Inquires," of this Practice Aid for a reprint of Appendix B to SSARS No. 1, as amended.]*

*This Statement titled Performance of Review Engagements was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

### **Accounting and Review Services Committee (2003–2004)**

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*Technical Manager*  
*Audit and Attest Standards*

**Note:** *Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a non-public entity. Rule 202, Compliance With Standards, of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARS.*



## **APPENDIX E: STATEMENT ON STANDARDS FOR ACCOUNTING AND REVIEW SERVICES NO. 11, STANDARDS FOR ACCOUNTING AND REVIEW SERVICES**

1. An accountant must perform a compilation or review of a non-public entity in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants. SSARS provide a measure of quality and the objectives to be achieved in both a compilation and review.

2. The SSARS are issued by the AICPA Accounting and Review Services Committee (ARSC) and provide performance and reporting standards for compilations and reviews.

3. Rule 202, *Compliance With Standards*, of the AICPA Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 202.01), requires an AICPA member who performs compilations or reviews to comply with standards promulgated by the ARSC. The ARSC develops and issues standards in the form of Statements on Standards for Accounting and Review Services through a due process that includes deliberations in meetings open to the public, public exposure of proposed SSARS, and a formal vote. The SSARS are codified.

4. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her engagement. The nature of the SSARS requires an accountant to exercise professional judgment in applying them. The accountant should be prepared to justify departures from the SSARS.

### **Interpretative Publications**

5. *Interpretative publications* consist of compilation and review Interpretations of the SSARS, appendixes to the SSARS, compilation and review guidance included in AICPA Audit and Accounting Guides, and AICPA Statements of Position to the extent that those Statements are applicable to compilation and review engagements. Interpretative publications are not standards for accounting and review services. Interpretative publications are recommendations on the application of the SSARS in specific circumstances, including engagements for entities in specialized industries. An interpretative

publication is issued after all ARSC members have been provided an opportunity to consider and comment on whether the proposed interpretative publication is consistent with the SSARS.

6. The accountant should be aware of and consider interpretative publications applicable to his or her compilation or review. If the accountant does not apply the guidance included in an applicable interpretative publication, the accountant should be prepared to explain how he or she complied with the SSARS provisions addressed by such guidance.

### Other Compilation and Review Publications

7. *Other compilation and review publications* include AICPA accounting and review publications not referred to above; AICPA's annual *Compilation and Review Alert*; compilation and review articles in the *Journal of Accountancy* and other professional journals; compilation and review articles in the *AICPA CPA Letter*; continuing professional education programs and other instruction materials, textbooks, guide books, compilation and review programs, and checklists; and other compilation and review publications from state CPA societies, other organizations, and individuals.<sup>1</sup> Other compilation and review publications have no authoritative status; however, they may help the accountant understand and apply the SSARS.

8. If an accountant applies the guidance included in an other compilation and review publication, he or she should be satisfied that, in his or her judgment, it is both relevant to the circumstances of the engagement, and appropriate. In determining whether an other compilation and review publication is appropriate, the accountant may wish to consider the degree to which the publication is recognized as being helpful in understanding and applying the SSARS and the degree to which the issuer or author is recognized as an authority in compilation and review matters. Other compilation and review publications published by the AICPA that have been reviewed by the AICPA Audit and Attest Standards staff are presumed to be appropriate.

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1. The accountant is not expected to be aware of the full body of other compilation and review publications.

## Predecessor's Compilation or Review Report

9. SSARS currently provide guidance to be followed when the financial statements of a prior period have been compiled or reviewed by a predecessor accountant whose report is not presented and the successor accountant has not compiled or reviewed those financial statements. This Statement amends AR section 200.17, footnote 9, to state that a successor accountant may name the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant. New language is shown in boldface italics.

<sup>9</sup>The successor ***accountant*** should not name the predecessor ***accountant*** in his ***or her*** report; ***however, the successor accountant may name the predecessor accountant if the predecessor accountant's practice was acquired by, or merged with, that of the successor accountant.***

## Effective Date

10. This Statement is effective upon issuance.

*This Statement titled Standards for Accounting and Review Services was adopted unanimously by the assenting votes of the seven members of the Accounting and Review Services Committee.*

### **Accounting and Review Services Committee (2003–2004)**

Andrew M. Cohen, *Chair*  
Suzanne M. Heidenreich  
Henry Krostich  
John J. Malahoski

Kurt Oestriecher  
Thomas A. Ratcliffe  
Mark E. Ziessman

### **AICPA Staff**

Charles E. Landes  
*Director*  
*Audit and Attest Standards*

Michael P. Glynn  
*Technical Manager*  
*Audit and Attest Standards*

**Note:** *Statements on Standards for Accounting and Review Services (SSARS) are issued by the AICPA Accounting and Review Services Committee (ARSC), the senior technical body of the Institute designated to issue pronouncements in connection with the unaudited financial statements or other unaudited financial information of a non-public entity. Rule 202, Compliance With Standards, of the Institute's Code of Professional Conduct requires an AICPA member who performs either a compilation or a review (the accountant) to comply with standards promulgated by the ARSC. The accountant should have sufficient knowledge of the SSARS to identify those that are applicable to his or her compilation or review and should be prepared to justify departures from the SSARS.*



# **APPENDIX F: ACCOUNTING AND REVIEW SERVICES COMMITTEE ISSUES PAPER, “ANALYTICAL PROCEDURES IN A REVIEW ENGAGEMENT”**

## **NOTICE TO READERS**

This Issues Paper is intended to provide accountants with information that may help them understand certain requirements related to the use of analytical procedures in review engagements and how the use of analytical procedures should be documented in those engagements. This publication is an *Other Compilation and Review Publication* as defined in Statement on Standards for Accounting and Review Services No. 11, *Standards for Accounting and Review Services*. *Other Compilation and Review Publications* have no authoritative status; however, they may help the accountant understand and apply Statements on Standards for Accounting and Review Services (SSARS). If an accountant applies the guidance included in an *Other Compilation and Review Publication*, the accountant should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of the subject engagement. This publication was reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA, and is presumed to be appropriate.

During the process of preparing to issue SSARS No. 10, *Performance of Review Engagements*, the Accounting and Review Services Committee (ARSC) determined that additional non-authoritative guidance would be helpful and appreciated by accountants with respect to the formation of expectations in the performance of analytical procedures. This Issues Paper is intended to provide additional non-authoritative guidance to accountants related to the use of analytical procedures and documentation requirements associated with those procedures.

### Expectations

**Forming an expectation is the most important phase of the analytical procedure process.** Expectations are the accountant’s predictions of recorded amounts or ratios developed from recorded amounts. In performing analytical procedures, the accountant develops the expectation in such a way that a material difference between the expectation and the recorded amount or ratio is indicative of a possible misstatement, and therefore the accountant should obtain explanations for the difference (for example, an unusual event occurred). Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant’s understanding of the client and the industry in which the client operates. The accountant selects from a variety of data sources to form expectations. For example, the accountant may use prior-period information (adjusted for expected changes), management’s budgets or forecasts, industry data, and/or non-financial data. Additionally, information that is developed when an accountant compiles interim financial statements can be utilized by the accountant in developing expectations associated with the review of financial statements.

SSARS No. 10 does not create a new requirement with respect to developing expectations. The Standard clarifies existing guidance that has existed since the issuance of SSARS No. 1, *Compilation and Review of Financial Statements*, in December 1978. An accountant cannot, under any circumstances, perform effective analytical procedures without first developing expectations related to the results of those analytical procedures. Expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements ordinarily are less encompassing than those developed in an audit.

SSARS No. 10 does, however, create the requirement that the accountant document significant expectations where those expectations are not otherwise readily determinable from the documentation of the work performed. The documentation should include factors considered in the development of the expectations.

The following represents examples of how an accountant can document expectations. These examples are not intended to be all inclusive.

#### **Example 1 – Expected increase in revenue**

An accountant is engaged to review the financial statements of a company that manufactures components that are utilized by other companies in customizing vehicles for use by the United States Military. Because of various conflicts occurring in the world and the United States' role in those conflicts, the accountant reasonably expects sales to increase. Using his or her knowledge of the client, the client's business, and the industry in which the client operates, the accountant expects a 10% to 15% increase in sales. Further, the accountant concludes that receivables should increase and that loans payable and interest expense would also increase as the client would need to borrow money to fund the additional production.

#### **Sample documentation**

Teemickmag Military Supply Company  
Analytical Procedures  
For the year ended December 31, 20XX

#### **Expectations**

The following are factors that should affect the relationship between current and prior year amounts:

Increase in military spending by the government due to world events should result in an increase in sales. Expected increase between 10% and 15%. The accountant expects a similar increase in accounts receivable.

Because of an increase in production of military vehicles, the Company had to borrow additional funds. Therefore, expected increase in loans payable and interest expense between 10% and 15%.

No significant change in either days sales in inventory or inventory turnover is expected. Although a build-up in inventory is expected, that build-up is not

expected to correspond with the increase in sales as the vehicles are expected to be sold near the date of completion. Any change greater than 5% will be subjected to additional inquiries.

Balance sheets and income statements are available for the current year and the two years preceding the current year.

Trend analysis

	Current Year	Prior Year	Change	% Change
Sales	\$ 2,500,000	\$ 2,175,000	\$325,000	14.94%
Cost of goods sold	1,780,000	1,566,000	214,000	13.67%
Gross margin	720,000	609,000		
Gross margin as a % of sales	28.80%	28.00%		
Selling expenses	230,000	184,000	46,000	25.00%
Interest expense	48,000	42,000	6,000	14.29%

Balance sheet ratio analysis

	<u>Current Year</u>	<u>Prior Year</u>	<u>Two Years Prior</u>
<u>Accounts receivable, net</u>	<u>\$ 1,100,000</u>	<u>\$ 843,000</u>	<u>\$ 703,000</u>
<u>Inventory</u>	<u>1,000,000</u>	<u>832,000</u>	<u>694,000</u>
<u>Loans payable</u>	<u>498,000</u>	<u>437,000</u>	<u>418,000</u>

Days sales in receivables

Days sales in receivables = Accounts receivable, net at end of period/ (Net sales/365)

Current year days sales in receivables = \$1,100,000 / (\$2,500,000/365)  
= 161 days

Prior year days sales in receivables = \$843,000 / (\$2,175,000/365)  
= 141 days

The increase of 20 days sales in receivables (161 days – 141 days) represents a 14% increase. Since this increase is within the expected range, no further inquiry is necessary.

Days sales in inventory

Days sales in inventory = Inventory at the end of period / (Total cost of goods sold / 365)

$$\begin{aligned}\text{Current year days sales in inventory} &= \$1,000,000 / (\$1,780,000 / 365) \\ &= 205 \text{ days}\end{aligned}$$

$$\begin{aligned}\text{Prior year days sales in inventory} &= \$832,000 / (\$1,566,000 / 365) \\ &= 194 \text{ days}\end{aligned}$$

The increase of 11 days sales in inventory (205 days – 194 days) represents a 6% increase. Since this increase is within the expected range, no further inquiry is necessary.

### Inventory turnover

Inventory turnover = Cost of goods sold / Average inventory

$$\begin{aligned}\text{Current year inventory turnover} &= \$1,780,000 / ((\$1,100,000 + 832,000) / 2) \\ &= 1.84 \text{ times}\end{aligned}$$

$$\begin{aligned}\text{Prior year inventory turnover} &= \$1,566,000 / ((\$832,000 + 694,000) / 2) \\ &= 2.05 \text{ times}\end{aligned}$$

The inventory turnover decreased 10% therefore, since this decrease is greater than expected, the accountant should inquire of the client and document the reason for the unexpected decrease.

The above documentation would be adequate and in accordance with SSARS No. 10. Further, after performing the trend analysis, the accountant concludes that sales, costs of goods sold and interest expense are all “reasonable” given the expectations associated with these amounts. In addition, with respect to balance sheet accounts, the increase in loans payable is also reasonable (14% increase) when considered with the corresponding increase in interest expense and the expectation associated with the loan payable account. However, since selling expenses increased by 25%, the accountant should inquire of the client and document the reason for that unexpected increase (actual increase does not correspond to expected increase).

### **Example 2 – Expected decrease in revenue**

An accountant is engaged to review the financial statements of a client that owns/manages a shopping mall. Due to a poor economy, the mall lost tenants during the year; as such, the accountant reasonably expects revenue to decrease. Using his or her knowledge of the client, the client’s business, and the industry in which the client operates, the accountant expects a 5% to 10% decrease in revenue during the year. Further, the accountant expects that general and administrative expenses should increase due to an increase in leasing and sales expenses and that management fees should decrease due to a decrease in tenants in the building.

**Sample documentation**

Pearl River Mall  
Analytical Procedures  
For the year ended December 31, 20XX

Expectations

The following are factors that should affect the relationship between current and prior year amounts:

- Loss of tenants due to poor economy should result in a decrease in revenue. Expected decrease between 5% and 10%.
- Because of the increased number of vacancies, general and administrative expenses are expected to increase because of an increase in leasing and sales expenses. Expected increase between 5% and 10% (corresponds with the decrease in revenue).
- Because of the decrease in the number of tenants in the building, management fees are expected to decrease between 5% and 10% (corresponds with decrease in revenue).

Balance sheets and income statements are available for the current and two years preceding the current year.

Trend analysis

	Current Year	Prior Year	Change	% Change
Tenant revenue	\$ 7,223,000	\$ 8,603,000	\$(1,380,000)	(16.04)%
Costs and expenses:				
Management fees	339,000	387,000	(48,000)	(12.40)%
General and administrative	583,000	511,000	72,000	14.09%

Similar balance sheet analytics should be performed as those performed in example 1 above.

The above documentation would be adequate and in accordance with SSARS No. 10. However, the results of the analytical tests do not agree with the documented expectations associated with those tests. Therefore, the accountant should inquire and document why the decrease in tenant revenue, the decrease in management fees, and the increase in general and administrative expenses exceeded expectations and document the results of the inquiry.

**Example 3 – No significant change in revenue or expenses expected**

An accountant is engaged to review the financial statements of a small, privately-held client in the candy store business. The accountant has performed a review of the financial statements of the candy store for each of the past five years with no significant

change in revenue or expenses in any of those years. The accountant expects that trend to continue.

**Sample documentation**

Mom and Pop Candy Store  
Analytical Procedures  
For the year ended December 31, 20XX

Expectations

Based on discussions with owner/manager, no significant changes from prior year amounts are expected.  
All increases/decreases greater than 5% will be subjected to additional inquiries.

Trend analysis

	Current Year	Prior Year	Change	% Change
Sales	\$44,000	\$ 39,000	\$5,000	12.82%
Cost of goods sold	32,500	31,000	1,500	4.84%
Gross margin	11,500	8,000		
Gross margin as a % of sales	26.14%	20.51%		
Operating expenses	5,200	4,500	700	15.56%
Net income	6,300	3,500		

Similar balance sheet analytics should be performed as those performed in example 1 above.

The above documentation would be adequate and in accordance with SSARS No. 10. However, the results of the analytical tests do not agree with the documented expectations associated with those tests. Therefore, the accountant should inquire and document why sales increased by an amount greater than expected. In addition, the accountant may want to inquire as to why there was not a comparable increase in cost of goods sold. Also, the accountant would want to discuss with the owner/manager why there is a greater than expected increase in operating expenses and document the results of the discussion.

Conclusion

The purpose of the documentation guidance contained in this Issues Paper is to illustrate how an accountant might document expectations in accordance with SSARS No. 10. The examples are presented for illustrative purposes only and should not be considered to represent either minimum or maximum documentation requirements.

