

On the record

How to determine which level of financial statement preparation is right for your company **Interviewed by Matt McClellan**

Whether your company has been requested to have a financial statement prepared by an outside CPA firm or is doing so voluntarily, the process can be extremely complex depending on what level of financial statement is requested. Many executives of privately held companies are unaware that they have three choices when preparing financial statements: compilations, reviews and audits. The complexity of the engagement is drastically different between the three, with an audit being the most complex. Obviously the more complex the engagement is, the more the cost will be.

"If you're having compiled financial statements prepared, the CPA is giving virtually no assurance that the statements are in accordance with generally accepted accounting principles (GAAP)," says Larry Kane, director of assurance services for Glenn M. Gelman & Associates CPAs. "If you're having reviewed statements prepared, the CPA is providing limited assurance that the financials are in accordance with GAAP. If you're having audited financial statements prepared, the CPA is assuring that the statements are in accordance with GAAP."

Smart Business spoke with Kane about how to determine which choice is right for your business and how to make the entire process less painful.

What are the primary differences between the three statements that companies can have prepared?

Assuming that all three levels of the financial statements were prepared in accordance with GAAP, the statements would look basically the same. The only significant difference would be the report issued by the CPA.

A compilation engagement consists of the CPA presenting, in the form of a financial statement, information that is the representation of company management. There is no assurance given that the statements are in accordance with GAAP. In a review engagement the CPA will perform various analytical procedures and make inquiries of company management in order to provide limited assurance that no material modifications should be made to the statements in order for them to be in accordance with GAAP.

An audit engagement requires the CPA to go way beyond what is required in compilations and reviews. The CPA must have



Larry Kane
Director of assurance services
Glenn M. Gelman & Associates

extensive knowledge of the company's business and the relevant industry it is in. They also must obtain a thorough understanding of the company's internal controls. In addition to gathering evidence and information about the company's financial statements, the CPA is required to corroborate this information. The firm will corroborate the information via methods such as outside verification, observation and confirmation.

The choice of which level is right for your company is either your own comfort level or that of the requesting party.

Assuming audits are the most complex and expensive, why would a company consider having an audit?

First of all, audit engagements are painful by nature. Most clients enjoy them about as much as going to a dentist for a root canal. However, if companies completely understood the benefits of an audit, they may not frown on them as much.

For the most part, an audit is usually dictated, which means someone such as a banker or other creditor has required the company to have one performed. In some cases, the owner of a company may request an audit be performed. He or she may view an audit as the best way to ensure the company financial statements are accurate.

LARRY M. KANE is a director with Glenn M. Gelman & Associates CPAs and Business Consultants. Reach him at (714) 667-2600 or lkane@gmgcpa.com.

How can an audit benefit your company?

The primary benefit of having an audit performed is the level of credibility associated with the engagement. An audit is the highest level of assurance a CPA can offer. Consequently, it is viewed very favorably by the general public. Having audited financials prepared can in many cases provide a company more opportunities for increased credit. In addition, there may be certain customers of companies who will only work with companies who have audited financial statements prepared.

As I noted earlier, auditors must have a thorough understanding of the client's system of internal controls. In addition, the auditors must go one step further and test them to see if they're operating as described. Knowing that these steps are performed by someone independent of their company gives management a comfort level they cannot achieve internally. Upon completion of an audit, the auditors are required to report to management any significant deficiencies or material weaknesses they observed as well as provide recommendations on how to improve in the areas noted.

How can businesses ensure the auditing process goes smoothly?

The best way to make sure an audit is as painless as possible is to put policies and procedures in place to satisfy the auditor's needs. Auditors are generally very structured. They have work programs in place to ensure they complete the audit in accordance with professional standards. Although every audit is different, there are still specific standards they must adhere to.

Prior to having an audit performed, the company should document its policies and procedures. They should have very specific organization charts, especially in the accounting department. They should have manuals, narratives or flow charts illustrating how and with whom tasks are performed. They should also perform tests of the system to ensure it's working as documented.

They should request the CPA provide them with a list of information he or she will require for the audit engagement. Determine what can be done by them versus the CPA. They should be very specific about timing of the engagement. Make sure they keep the dates. <<

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