

Financial Statements: What are my options?

By Richard Wolf



When a small or mid-sized business needs financial statements prepared by a public accounting firm, many owners are unsure of the different alternatives available. When meeting

with a banker, attorney or a bonding agent, it can be confusing understanding the differences between the various levels of service: audits, reviews and compilations. Which one is right for your company and what does each entail?

An audit is defined as a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.

An audit is the highest level of assurance that a public accounting firm can provide on the fairness of the financial statements. It is important to note that an audit can only provide “reasonable assurance” about whether the financial statements are free of material misstatement; it does not provide absolute assurance. An audit includes examining, on a test basis, the evidence that supports the balances and footnote

disclosures in the financial statements. As part of an audit, the public accountants are required to assess the accounting principles used and also to evaluate the significant estimates made by management.

A compilation can only be performed on nonpublic entities and it involves presenting, in the form of financial statements, information that is the representation of management/owners without expressing any assurance on the statements. A compilation can be performed that omit substantially all of the required footnote disclosures. In addition, a compilation is the only level of service that can be performed if the CPA lacks independence.

Reviewed financial statements provide less assurance than an audit, but more assurance than a compilation. A review involves performing inquiry and analytical procedures to provide a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles.

The question as to whether or not you need an audit, review or compilation is really a question of the level of assurance that is required on the financial statements. In some cases, management can determine the level of assurance that it requires; however, when banks or other creditors are involved, what is best for management often becomes secondary to what is best

for the creditor. Frequently a user of the financial statements, such as a bank or bonding company, will require a specific level of service.

In addition, certain state regulations may require a specific level of service. For example, many nonprofit organizations are required to submit audited financial statements for registration if their gross receipts exceed a certain dollar amount. Common interest realty associations (CIRAs) are also frequently required to submit audited financial statements to the applicable state regulatory authorities.

In addition to the difference in the level of assurance, there are significant differences in the three levels as it relates to cost and the amount of procedures performed. Typically a compilation is the least expensive service and involves a minimal amount of accumulated evidence. An audit is typically the most expensive as a result of the extensive amount of evidence required to provide such a high level of assurance.

Your accountant can further explain the differences between the various levels of service, and can also be an excellent resource when trying to negotiate with a bank or bonding company.

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