

## **Accounting Procedures, Compilations, Reviews, and Audits for those of us who are not accountants.**

As tax season approaches people and business begin to consolidate their financial information to take it to their accountant or tax preparer. Often many tax preparation chains or accountants offer guarantees about the returns prepared or the condition of your books but what do those guarantees really mean?

What those guarantees mean is determined by what service is being performed. Before we can understand those services however we need to understand a few basic accounting principles.

In the U.S., **generally accepted accounting principles**, commonly abbreviated as **US GAAP** or simply **GAAP**, are accounting rules used to prepare, present, and report [financial statements](#) for a wide variety of entities, including [publicly-traded](#) and [privately-held](#) companies, [non-profit organizations](#), and governments. Generally GAAP includes local applicable Accounting Framework, related accounting law, rules and Accounting Standard.

What this means is that GAAP is the standard by which accounting work is done. Bound by assumptions, principles, and constraints the financial reporting should provide information that is:

Useful to present to potential investors and creditors and other users in making rational investment, credit, and other financial decisions.

Helpful to present to potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts.

About economic resources, the claims to those resources, and the changes in them

The US GAAP provisions differ somewhat from [International Financial Reporting Standards](#) (IFRS), though former SEC Chairman [Chris Cox](#) set out a timetable for all U.S. companies to drop GAAP by 2016, with the largest companies switching to IFRS as early as 2009. but for the time being GAAP is the standard.

[http://en.wikipedia.org/wiki/Generally\\_Accepted\\_Accounting\\_Principles\\_%28United\\_States%29](http://en.wikipedia.org/wiki/Generally_Accepted_Accounting_Principles_%28United_States%29)

There are 2 basic methods of accounting cash basis accounting and Accrual based accounting. I went to Investopedia to find some answers as to the differences between them and the advantages and disadvantages to each.

## **Cash Basis accounting**

### **What Does *Cash Basis* Mean?**

A major accounting method that recognizes revenues and expenses at the time physical cash is actually received or paid out. This contrasts to the other major accounting method, accrual accounting, which requires income to be recognized in a company's books at the time the revenue is earned (but not necessarily received) and records expenses when liabilities are incurred (but not necessarily paid for).

### **Investopedia explains *Cash Basis***

When transactions are recorded on a cash basis, they affect a company's books only once a completed exchange of value has occurred; therefore, cash basis accounting is less accurate than accrual accounting in the short term.

For example, let's say a construction company secures a major contract in a given year, but will only be paid for its efforts upon completion of the project. Using cash basis accounting, the company will only be able to recognize the revenue from its project at its completion, while it will record the project's expenses as they are being paid out. If the project's time span is greater than one year, the company's income statements will be misleading: the company will incur large losses one year and then great gains the next. Cash basis accounting is simpler and cheaper to perform than accrual accounting, but it can make obtaining financing more difficult due to its inaccuracy.

So cash basis accounting is simpler and cheaper since your only tracking the flow of cash but inaccurate which may hurt a business ability to receive financing. If your books are

not very complicated and money changes hands quickly Cash basis accounting might work for your business.

<http://www.investopedia.com/terms/c/cashbasis.asp>

## **Accrual based accounting**

### **What Does *Accrual Accounting* Mean?**

An accounting method that measures the performance and position of a company by recognizing economic events regardless of when [cash](#) transactions occur. The general idea is that economic events are recognized by matching revenues to expenses (the matching principle) at the time in which the transaction occurs rather than when payment is made (or received). This method allows the current cash inflows/outflows to be combined with future expected cash inflows/outflows to give a more accurate picture of a company's current financial condition.

### **Investopedia explains *Accrual Accounting***

Accrual accounting is considered to be the standard accounting practice for most companies, with the exception of very small operations. This method provides a more accurate picture of the company's current condition, but its relative complexity makes it more expensive to implement. This is the opposite of cash accounting, which recognizes transactions only when there is an exchange of cash.

The need for this method arose out of the increasing complexity of business transactions and a desire for more accurate financial information. Selling on credit and projects that provide revenue streams over a long period of time affect the company's financial condition at the point of the transaction. Therefore, it makes sense that such events should also be reflected on the [financial statements](#) during the same reporting period that these transactions occur.

For example, when a company sells a TV to a [customer](#) who uses a credit card, cash and accrual methods will view the event differently. The revenue generated by the sale of the

TV will only be recognized by the cash method when the money is received by the company. If the TV is purchased on credit, this revenue might not be recognized until next month or next year.

Accrual accounting, however, says that the cash method isn't accurate because it is likely, if not certain, that the company will receive the cash at some point in the future because the sale has been made. Therefore, the accrual accounting method instead recognizes the TV sale at the point at which the customer takes ownership of the TV. Even though cash isn't yet in the bank, the sale is booked to an account known in accounting lingo as "accounts receivable," increasing the seller's revenue.

<http://www.investopedia.com/terms/a/accrualaccounting.asp>

## **Compilation**

Presentation of financial statement information by the entity *without* the accountant's assurance as to conformity with [Generally Accepted Accounting Principles \(GAAP\)](#). In performing this accounting service, the accountant must conform to the [American Institute of Certified Public Accountants \(Aicpa\)](#) Statements on Standards for Accounting and Review Services (SSARS). For guidance on issues not covered therein, reference should be made to the [Statements on Auditing Standards \(SAS\)](#). The engagement letter should set forth the type of services to be rendered, limitations of the service (such as nonreliance to disclose errors and irregularities), and nature of the compilation report. In undertaking a compilation assignment, the CPA should be familiar with the client and industry accounting principles and practices. The accountant should understand the client's accounting records, form and content of financial statements, and personnel qualifications. The accountant is *not* gathering evidence and does *not* verify client information provided. Rather, the CPA reads the compiled statements to assure that they are in appropriate form and without obvious material errors. Each page of the financial statement should refer to the compilation report. The accountant's report should indicate

the completion of the compilation, the fact that the compilation is restricted to financial statement information presented by management, and that the statements have *not* been audited or reviewed. The accountant does not express an opinion on the financial statements nor does he or she give any other form of assurance on them. In the case where management omits needed disclosures, the CPA should state so in the report.

<http://www.answers.com/topic/compilation>

A compilation is the quickest way to get the books to appear in order but has the least safeguards since all the accountant is doing is making sure that the forms are filled out correctly. The accountant is not verifying that the information provided is accurate only that it was recorded accurately. Accountants when making a compilation are only required to note abnormalities if information was omitted. The same group that prepared the documentation can do a compilation in house.

## **Review**

Auditing process that tests relationships among accounts and identifies material changes. It involves analyzing significant ratios and trends for unusual change and questionable items. Included in the analytical review process are: (1) reading important documents and analyzing their accounting and financial effects; (2) reviewing the activity in an account between interim and year-end, especially noting entries out of the ordinary; (3) comparing current period account balances to prior periods as well as to budgeted amounts, noting reasonableness of account balances by evaluating logical relationships among them (i.e., relating payables to expenses, accounts receivable to sales). In essence, therefore, analytical review involves reading the Financial Statements, scanning the figures, making comparisons to prior periods, appraising logical relationships among accounts, tracing financial statement items to the financial statements, and analyzing the overall process. The degree of analytical review required depends on the [Materiality](#) of the item, available supporting data, and the quality of the internal control system. Analytical review assists in assuring the accuracy and reliability of the accounts.

<http://www.answers.com/topic/analytical-review-in-accounting>

The review process is a mid strength analysis of the fiscal practices and procedures of a company. The review actually looks for discrepancies in the books of the client and notes where abnormalities and issues for improvement may exist. The review by comparing previous years financial data as well as items with logical correlation such as expenses and payables will help a management team make sure that not only that their books are filled out correctly but also that there are no unresolved irregularities in fiscal reporting. The same group that performed the supporting documentation can do the review.

## **Audit**

Examination of the records and reports of an enterprise by accounting specialists other than those responsible for their preparation. Public auditing by independent accountants is common in large firms. The auditor performs tests to determine whether the firm's statements were prepared in accordance with acceptable accounting principles and that they fairly present its financial position and operating results. Personal tax audits are carried out to determine whether people have accurately reported their financial circumstances when filing their taxes. Failing such an audit may result in a fine, or, in cases of extensive and deliberate deception, criminal prosecution.

[http://en.wikipedia.org/wiki/Generally\\_Accepted\\_Accounting\\_Principles\\_%28United\\_States%29](http://en.wikipedia.org/wiki/Generally_Accepted_Accounting_Principles_%28United_States%29)

The audit, arguably no word causes more trepidation to the small business owner when considering their accounting books. Different team of accountants, not the team who prepared the books, does audits. In an audit the auditor tests the statements and whether those statements fairly present its financial position and operating results.

