

2002

Proposed statement on auditing standards : Interim financial information : (to supersede Statement on auditing standards no. 71, Interim financial information; Interim financial information : (to supersede Statement on auditing standards no. 71, Interim financial information

American Institute of Certified Public Accountants. Auditing Standards Board

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_sop

Part of the [Accounting Commons](#), and the [Taxation Commons](#)

Recommended Citation

American Institute of Certified Public Accountants. Auditing Standards Board, "Proposed statement on auditing standards : Interim financial information : (to supersede Statement on auditing standards no. 71, Interim financial information; Interim financial information : (to supersede Statement on auditing standards no. 71, Interim financial information" (2002). *Statements of Position*. 294. https://egrove.olemiss.edu/aicpa_sop/294

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Statements of Position by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.

EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

INTERIM FINANCIAL INFORMATION

**(To Supersede Statement on Auditing Standards No. 71, *Interim
Financial Information*)**

July 26, 2002

**Prepared by the AICPA Auditing Standards Board for comment from persons interested in
auditing and reporting issues**

**Comments should be received by September 26, 2002, and should be addressed to
Sharon Macey, Audit and Attest Standards,
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775
or via the Internet to smacey@aicpa.org**

Copyright © 2002 by American Institute of Certified Public Accountants, Inc.

Permission is granted to make copies of this work provided that such copies are for personal, intraorganizational, or educational use only and are not sold or disseminated and provided further that each copy bears the following credit line: "Copyright © 2002 by American Institute of Certified Public Accountants, Inc. Used with permission."

July 26, 2002

Accompanying this letter is an exposure draft, approved by the Auditing Standards Board (ASB), of a proposed Statement on Auditing Standards (SAS) entitled *Interim Financial Information*. This proposed SAS revises the guidance on performing reviews of interim financial information.

A summary of the significant provisions of the proposed SAS accompanies this letter.

Comments or suggestions on any aspect of this exposure draft will be appreciated. To facilitate the ASB's consideration of responses, comments should refer to specific paragraphs and include supporting reasons for each suggestion or comment.

In developing guidance, the ASB considers the relationship between the cost imposed and the benefits reasonably expected to be derived from reviews of interim financial information. Thus, the ASB would appreciate comments on those matters.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after October 26, 2002, for one year. Responses should be sent to Sharon Macey, Audit and Attest Standards, AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775 in time to be received by September 26, 2002. Responses also may be sent by electronic mail to smacey@aicpa.org.

Sincerely,

James S. Gerson
Chair
Auditing Standards Board

Charles E. Landes
Director
Audit and Attest Standards

**Auditing Standards Board
(2001-2002)**

James S. Gerson, *Chair*
Jeffrey C. Bryan
Linda K. Cheatham
Craig W. Crawford
John A. Fogarty
Lynford Graham
Auston G. Johnson

Michael P. Manspeaker
Susan L. Menelaides
Alan G. Paulus
Mark Scoles
Bruce P. Webb
O. Ray Whittington
Carl L. Williams III

SAS No. 71 Task Force

Richard Dieter, *Chair*
Alan G. Paulus, *Chair, as of, June 5, 2002*

Keith O. Newton
Robert C. Steiner

The AICPA is grateful to Maria C. Manasses for her technical assistance with this document.

AICPA Staff

Charles E. Landes
Director
Audit and Attest Standards

Judith M. Sherinsky
Technical Manager
Audit and Attest Standards

SUMMARY

WHY ISSUED AND WHAT IT DOES

This proposed Statement on Auditing Standards (SAS) establishes standards and provides guidance to an accountant performing a review of interim financial information of:

- A public entity, or
- A nonpublic entity that makes a filing with a regulatory agency in preparation for a public offering or listing, and has had or is currently having its latest annual financial statements audited.

The term *interim financial information* means financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end.

The term *accountant*, as used in this SAS, refers to a CPA performing a review engagement.

The standards and guidance for performing reviews of interim financial information currently reside in SAS No. 71, *Interim Financial Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 722). The Auditing Standards Board (ASB) is revising SAS No. 71 to provide additional guidance on performing reviews of interim financial information and to incorporate the requirement of the Securities Exchange Commission (SEC) for timely filings of interim financial information. This proposed SAS also incorporates relevant recommendations of the Public Oversight Board's Panel on Audit Effectiveness in its August 31, 2000 document, *Report and Recommendations*, as well as recommendations of the AICPA's Professional Issues Task Force in Practice Alert 2000-4, "Quarterly Review Procedures for Public Companies."

This proposed SAS revises SAS No. 71 by:

- Clarifying the applicability of generally accepted auditing standards to a review of interim financial information.
- Citing the SEC requirement that an entity engage an independent accountant to review the entity's interim financial information *before* the entity files its quarterly report on Form 10-Q or Form 10-QSB, and modifying the relevant guidance in the SAS to reflect this requirement.
- Providing guidance to an accountant performing *an initial review* of interim financial information. A review engagement is deemed an initial review if the accountant has not audited the financial statements of the previous year end.
- Requiring an accountant to establish an understanding with his or her client regarding the services to be performed in an interim review engagement, and specifying the matters generally included in that understanding.
- Requiring the accountant to perform certain additional specified procedures in an interim review engagement, including:
 - Comparing disaggregated revenue data, for example, comparing revenue reported by month and by product line or business segment for the current interim period with that of comparable prior periods.
 - Obtaining evidence that the interim financial information agrees or reconciles with the accounting records.

- Inquiring of members of management who have responsibility for financial and accounting matters about their knowledge of any fraud perpetrated on the entity, any alleged or suspected fraud, or any allegations of fraudulent financial reporting on the part of the entity received in communications from employees, former employees, short sellers, financial analysts, or others.
- Providing an illustrative report for a review of comparative interim financial information.
- Providing guidance on the accountant's consideration, in an interim review engagement, of matters related to an entity's ability to continue as a going concern, and presenting reporting options related to such matters.
- Adding an appendix to the SAS that presents examples of analytical procedures the accountant may consider performing in a review of interim financial information.
- Adding an appendix to the SAS that provides examples of unusual or complex situations an accountant would ordinarily consider inquiring about when conducting a review of interim financial information.
- Adding an appendix to the SAS containing two illustrative representation letters for a review of interim financial information. The first letter is designed to be used independently of any other letter. The second letter is designed to be used in conjunction with the representation letter for the audit of the financial statements of the prior year end.

HOW IT AFFECTS EXISTING STANDARDS

This proposed SAS would supersede SAS No. 71.

PROPOSED STATEMENT ON AUDITING STANDARDS INTERIM FINANCIAL INFORMATION

INTRODUCTION

1. The purpose of this Statement is to establish standards and provide guidance on the nature, timing, and extent of the procedures to be performed by an independent accountant when conducting a review of *interim financial information* (as that term is defined in paragraph 2). The three general standards discussed in Statement on Auditing Standards (SAS) No. 1, *Codification of Auditing Standards and Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 150.02, “Generally Accepted Auditing Standards”), are applicable to a review of interim financial information conducted in accordance with this Statement. This Statement provides guidance on the application of the field work and reporting standards to a review of interim financial information, to the extent those standards are relevant.

2. For purposes of this Statement, the term *interim financial information* means financial information or statements covering a period less than a full year or for a 12-month period ending on a date other than the entity's fiscal year end.

3. The Securities and Exchange Commission (SEC) requires¹ an entity to engage an independent accountant to review the entity's interim financial information, in accordance with this Statement, before the entity files its quarterly report on Form 10-Q or Form 10-QSB. Although this Statement does not require an accountant to issue a written report on a review of interim financial information, the SEC requires that an accountant's review report be filed with the interim financial information if, in any filing, the entity states that the interim financial information has been reviewed by an independent public accountant. Paragraphs 36 through 45 of this Statement provide reporting guidance for a review of interim financial information.

4. Many SEC registrants are required by Item 302(a) of Regulation S-K to include selected quarterly financial data (that is, interim financial information for each full quarter within the two most recent fiscal years and any subsequent interim period for which financial statements are included or are required to be included) in their annual reports and in certain other SEC filings. Consequently, a review of the entity's fourth quarter interim financial information must be conducted even though a quarterly report for the fourth quarter is not filed on Form 10-Q. Furthermore, an accountant performing an initial audit of an entity's annual financial statements who has not previously reviewed one or more of the quarters in that year should perform a review of those quarters, in accordance with this Statement, in order to report on the audited financial statements containing such interim financial information.

5. SAS No. 84, *Communication Between Predecessor and Successor Auditors* (AICPA, *Professional Standards*, vol. 1, AU sec. 315), requires a successor auditor to contact the entity's predecessor auditor and make inquiries of the predecessor auditor in deciding whether to accept appointment as an entity's independent auditor. Such inquiries should be completed before accepting an engagement to perform an initial review of an entity's interim financial information.

¹ The SEC requirement is set forth in Rule 10-01(d) of Regulation S-X for Form 10-Q and Item 310(b) of Regulation S-B for Form 10-QSB.

APPLICABILITY²

6. An accountant may conduct, in accordance with this Statement, a review of the interim financial information of a public entity and its subsidiaries or of a nonpublic entity that makes a filing with a regulatory agency³ in preparation for a public offering or listing, if the entity's latest annual financial statements have been or are being audited. The interim financial information may be presented in the form of financial statements or in a summarized form that purports to conform with generally accepted accounting principles⁴ and applicable regulatory requirements, for example, Article 10 of Regulation S-X for Form 10-Q.

OBJECTIVE OF A REVIEW OF INTERIM FINANCIAL INFORMATION

7. The objective of a review of interim financial information is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with accounting principles generally accepted in the United States of America. The objective of a review of interim financial information differs significantly from that of an audit. A review of interim financial information does not provide a basis for expressing an opinion about whether the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. A review consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters, and does not contemplate (a) tests of accounting records through inspection, observation, or confirmation; (b) tests of controls to evaluate their effectiveness; (c) obtaining corroborating evidential matter in response to inquiries; or (d) performing certain other procedures ordinarily performed in an audit. A review may bring to the accountant's attention significant matters affecting the interim financial information, but it does not provide assurance that the accountant will become aware of all significant matters that would be identified in an audit. Paragraph 24 of this Statement provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles.

ESTABLISHING AN UNDERSTANDING WITH THE CLIENT

8. The accountant should establish an understanding with the client regarding the services to be performed in an interim review engagement.⁵ Such an understanding reduces the risk that either the accountant or the client may misinterpret the needs or expectations of the other party. This understanding should include the objectives of the engagement, management's

² Statements on Standards for Accounting and Review Services provide guidance for reviews of financial statements of nonpublic entities.

³ For purposes of this Statement, a *regulatory agency* is the Securities and Exchange Commission (SEC) and the following agencies with which an entity files periodic reports pursuant to the Securities Exchange Act of 1934: Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, Federal Reserve System, and Office of Thrift Supervision.

⁴ Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*, outlines the application of U.S. generally accepted accounting principles to the determination of income when interim financial information is presented, provides for the use of estimated effective income tax rates, and specifies certain disclosure requirements for summarized financial information issued by public companies. Footnote 3 of Statement on Auditing Standards (SAS) No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles* (AICPA, *Professional Standards*, vol. 1, AU sec. 411.10), indicates that for SEC registrants, rules and interpretive releases of the SEC have an authority similar to that of category "a" accounting principles.

⁵ See Statement on Quality Control Standards No. 2, *System of Quality Control for a CPA Firm's Accounting and Auditing Practice* (AICPA, *Professional Standards*, vol. 2, QC sec. 20.16).

responsibilities, the accountant's responsibilities, and the limitations of the engagement. The accountant should document this understanding, preferably through a written communication with the client. If the accountant believes an understanding with the client has not been established, he or she should decline to accept or perform the engagement.

9. An understanding with the client regarding a review of interim financial information generally includes the following matters:

- The objective of a review of interim financial information is to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with accounting principles generally accepted in the United States of America.
- Management is responsible for the entity's interim financial information.
- Management is responsible for establishing and maintaining effective internal control over financial reporting.
- Management is responsible for identifying and ensuring that the entity complies with the laws and regulations applicable to its activities.
- Management is responsible for making all financial records and related information available to the accountant.
- At the conclusion of the engagement, management will provide the accountant with a letter confirming certain representations made during the review.
- Management is responsible for adjusting the interim financial information to correct material misstatements. Although a review of interim financial information is not designed to obtain reasonable assurance that the interim financial information is free from material misstatement, management also is responsible for affirming to the accountant in its representation letter that the effects of any uncorrected misstatements aggregated by the accountant in a schedule accompanying the representation letter are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole.
- The accountant is responsible for conducting the review in accordance with standards established by the AICPA. A review of interim financial information consists principally of performing analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole.
- A review includes obtaining sufficient knowledge of the entity's business and its internal control as it relates to the preparation of both annual and interim financial information to:
 - Identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.
 - Select the inquiries and analytical procedures that will provide the accountant with a basis for communicating whether he or she is aware of any material

modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.

- A review is not designed to provide assurance on internal control or to identify reportable conditions. However, the accountant is responsible for ensuring that the audit committee or others with equivalent authority or responsibility are aware of any reportable conditions that come to his or her attention.

THE ACCOUNTANT'S KNOWLEDGE OF THE ENTITY'S BUSINESS AND ITS INTERNAL CONTROL

10. To perform a review of interim financial information, the accountant should have sufficient knowledge of the entity's business and its internal control as it relates to the preparation of both annual and interim financial information to:

- Identify the types of potential material misstatements in the interim financial information and consider the likelihood of their occurrence.
- Select the inquiries and analytical procedures that will provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.

11. In planning a review of interim financial information, the accountant should perform procedures to update his or her knowledge of the entity's business to (a) aid in the determination of the inquiries to be made and the analytical procedures to be performed and (b) identify particular events, transactions, or assertions to which the inquiries may be directed or analytical procedures applied. Such procedures should include:

- Reading documentation of the preceding year's audit and of reviews of prior interim period(s) of the current year and corresponding quarterly and year-to-date interim period(s) of the prior year to the extent necessary, based on the accountant's judgment, to enable the accountant to identify matters that may affect the current-period interim financial information. The accountant should specifically consider the nature of any (a) corrected material misstatements; (b) matters identified in any summary of uncorrected misstatements⁶; (c) identified risks of material misstatement due to fraud, including the risk of management override of controls; and (d) significant financial accounting and reporting matters that may be of continuing significance, such as weaknesses in internal control.
- Reading the most recent annual and comparable prior interim period financial information.
- Considering the results of any audit procedures performed with respect to the current year's financial statements.
- Inquiring of management about changes in the entity's business activities.

⁶ SAS No. 47, *Audit Risk and Materiality* (AICPA, *Professional Standards*, vol. 1, AU sec. 312.40), requires the auditor to document the nature and effect of misstatements that the auditor aggregates as well as the auditor's conclusion as to whether the aggregated misstatements cause the financial statements to be materially misstated.

12. In an initial review of interim financial information, the accountant should perform procedures that will enable him or her to obtain a sufficient understanding of the entity's business and its internal control to determine the inquiries to be made and the analytical procedures to be performed to meet the objective of a review of interim financial information described in paragraph 7. Ordinarily, an accountant performing an initial review of interim financial information makes inquiries of the predecessor accountant and reviews the predecessor accountant's documentation for the preceding annual audit and for any prior interim periods in the current year that have been reviewed by the predecessor accountant, to assist in obtaining the knowledge that will enable him or her to determine the inquiries to be made and the analytical procedures to be performed. In doing so, the accountant should specifically consider the nature of any (a) corrected material misstatements; (b) matters identified in any summary of uncorrected misstatements; (c) identified risks of material misstatement due to fraud, including the risk of management override of controls; and (d) significant financial accounting and reporting matters that may be of continuing significance, such as weaknesses in internal control. If the predecessor accountant does not respond to the successor accountant's inquiries, the successor accountant should use alternative procedures to obtain the applicable knowledge. The accountant also may consider reviewing the predecessor accountant's documentation related to reviews of interim period(s) in the prior year.

13. Knowledge of an entity's internal control, as it relates to the preparation of both annual and interim financial information, includes knowledge of the relevant aspects of the control environment, the entity's *risk assessment process, control activities, information and communication, and monitoring*, as those terms are defined in SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 319.06 -.07), as amended. The accountant who has audited the entity's financial statements for one or more annual periods ordinarily would have acquired sufficient knowledge of an entity's internal control as it relates to the preparation of annual financial information and may have acquired such knowledge with respect to interim financial information. If the accountant has not audited the most recent annual financial statements, the accountant should perform procedures to obtain such knowledge. Internal control over the preparation of interim financial information may differ from internal control over the preparation of annual financial statements because certain accounting principles and practices used for interim financial information may differ from those used for the preparation of annual financial statements, for example, the use of estimated effective income tax rates for the preparation of interim financial information, which is prescribed by Accounting Principles Board (APB) Opinion No. 28, *Interim Financial Reporting*.

14. An accountant should inquire about and perform procedures to determine whether there have been any significant changes in the entity's internal control and, if so, their potential effect on the preparation of the interim financial information. To obtain that knowledge, the accountant should inquire of management as to whether significant changes in internal control have occurred subsequent to the preceding annual audit or prior review of interim financial information, including changes in the entity's policies, procedures, and personnel, as well as the nature and extent of such changes. A restriction on the scope of the review may be imposed if the entity's internal control appears to contain deficiencies so significant that it would be impracticable for the accountant, based on his or her judgment, to effectively perform review procedures that would provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.

15. The accountant's knowledge of an entity's business and its internal control influences the inquiries and analytical procedures performed. For example, if the accountant becomes aware of a significant change in the entity's control activities at a particular location, the accountant may consider (a) making additional inquiries, such as whether management monitored the changes

and considered whether they were operating as intended, and/or (b) employing analytical procedures with a more precise expectation.

PROCEDURES FOR A REVIEW OF INTERIM FINANCIAL INFORMATION

16. Procedures for conducting a review of interim financial information generally are limited to inquiries and analytical procedures that address significant accounting and disclosure matters relating to the interim financial information to be reported. The specific inquiries made and analytical procedures performed should be tailored to the engagement based on the accountant's knowledge of the entity's business and its internal control.

17. *Analytical procedures and related inquiries.* The accountant should apply analytical procedures to the interim financial information 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, for the purposes of this Statement, should include:

- Comparing the quarterly interim financial information with comparable information for the immediately preceding interim period and the quarterly and year-to-date interim financial information with the corresponding period(s) in the previous year, giving consideration to known changes.
- Considering plausible relationships among both financial and, where relevant, nonfinancial information. The accountant also may wish to consider information developed and used by the entity, for example, information in a director's information package or in a senior committee's briefing materials.
- Comparing recorded amounts, or ratios developed from recorded amounts, to expectations developed by the accountant. The accountant develops such 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 (see paragraph 19).
- Comparing disaggregated revenue data, for example, comparing revenue reported by month and by product line or business segment during the current interim period with that of comparable prior periods.

See Appendix A of this Statement for examples of analytical procedures an accountant may consider performing when conducting a review of interim financial information.

18. These analytical procedures are performed in connection with the inquiries of management and certain other review procedures to provide the accountant with a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information for it to conform with generally accepted accounting principles.

19. Expectations developed by the accountant in performing analytical procedures in connection with a review of interim financial information ordinarily are less precise than those developed in an audit. Also, in a review the accountant ordinarily is not required to corroborate management's responses with other evidential matter. However, the accountant should consider the 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 its internal control. The accountant may find the guidance in SAS No. 56, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 329), useful in conducting a review of interim financial information. Paragraph 24 of this

Statement provides guidance to the accountant if he or she becomes aware of information that leads him or her to believe that the interim financial information may not be in conformity with generally accepted accounting principles.

20. *Other review procedures.* The following are other review procedures the accountant should perform when conducting a review of interim financial information:

a. Reading the available minutes of meetings of stockholders, directors, and appropriate committees, and inquiring about matters dealt with at meetings for which minutes are not available, to identify matters that may affect the interim financial information.

b. Obtaining reports from other accountants, if any, who have been engaged to perform a review of the interim financial information of significant components of the reporting entity, its subsidiaries, or its other investees, or inquiring of those accountants if reports have not been issued.⁷

c. Inquiring of members of management who have responsibility for financial and accounting matters concerning:

- Whether the interim financial information has been prepared in conformity with generally accepted accounting principles consistently applied.
- Unusual or complex situations that may have an effect on the interim financial information. (See Appendix B of this Statement for examples of unusual or complex situations to be considered by the accountant when conducting a review of interim financial information.)
- Significant transactions occurring in the last several days of the interim period.
- Matters about which questions have arisen in the course of applying the review procedures.
- Events subsequent to the date of the interim financial information that could have a material effect on the presentation of such information.
- Knowledge of any fraud that has been perpetrated on the entity or any alleged or suspected fraud involving:
 - Management;
 - Employees who have significant roles in the financial reporting process; or
 - Others, if the fraud could have a material effect on the interim financial information.
- Knowledge of any allegations of fraudulent financial reporting on the part of the entity received in communications from employees, former employees, short sellers, financial analysts, or others.

⁷ In these circumstances, the accountant ordinarily is in a position similar to that of an auditor who acts as principal auditor (see SAS No. 1, *Codification of Auditing Standards and Procedures* [AICPA, *Professional Standards*, vol. 1, AU sec 543, "Part of Audit Performed by Other Independent Auditors"]) and makes use of the work or reports of other auditors in the course of an audit of financial statements.

d. Obtaining evidence that the interim financial information agrees or reconciles with the accounting records. For example, the accountant may trace the interim financial information to (a) the accounting records, such as the general ledger; (b) a consolidating schedule derived from the accounting records; and/or (c) other supporting data in the entity's records. In addition, the accountant should consider inquiring of management as to the reliability of the records to which the interim financial information was traced or reconciled, including considering the source of the data, as well as other knowledge the accountant may have.

e. Reading the interim financial information to consider whether, on the basis of information coming to the accountant's attention, the information to be reported conforms with generally accepted accounting principles.

f. Reading other information that accompanies the interim financial information and is contained in reports (a) to holders of securities or beneficial interests and (b) filed with regulatory authorities under the Securities Exchange Act of 1934 (such as Form 10-Q or 10-QSB), to consider whether such information or the manner of its presentation is materially inconsistent with the interim financial information.⁸ If the accountant concludes that there is a material inconsistency, or becomes aware of information that he or she believes is a material misstatement of fact, the action taken will depend on his or her judgment in the particular circumstances. In determining the appropriate course of action, the accountant should consider the guidance in paragraphs 4 through 6 of SAS No. 8, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 550).

Many of the aforementioned review procedures can be performed before or simultaneously with the entity's preparation of the interim financial information. For example, it may be practicable to update the understanding of the entity's internal control and begin reading applicable minutes before the end of an interim period. Performing some of the review procedures earlier in the interim period also permits early identification and consideration of significant accounting matters affecting the interim financial information.

21. Written representations from management should be obtained for all interim financial information presented and for all periods covered by the review. Specific representations should relate to the following matters:

Financial Statements

a. Management's acknowledgement of its responsibility for the fair presentation in the interim financial information of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

b. Management's belief that the interim financial information has been prepared and presented in conformity with generally accepted accounting principles applicable to interim financial information.

Completeness of Information

c. Availability of all financial records and related data.

d. Completeness and availability of all minutes of meetings of stockholders, directors, and committees of directors.

⁸ The principal accountant also may request other accountants involved in the engagement, if any, to read the other information.

e. Communications with regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.

f. Absence of unrecorded transactions.

Recognition, Measurement, and Disclosure

g. Management's belief that the effects of any uncorrected financial statement misstatements aggregated by the accountant during the current engagement and pertaining to the latest interim period presented are immaterial, both individually and in the aggregate, to the interim financial information taken as a whole. (A summary of such items should be included in or attached to the letter.)⁹

h. Information concerning fraud involving (1) management, (2) employees who have significant roles in the financial reporting process, or (3) others if the fraud could have a material effect on the interim financial information.

i. Knowledge of any allegations of fraudulent financial reporting on the part of the entity received in communications from employees, former employees, short sellers, financial analysts, or others.

j. Acknowledgment of management's responsibility for the design and implementation of programs and controls to prevent and detect fraud.

k. Plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

l. Information concerning related-party transactions and amounts receivable from or payable to related parties.

m. Guarantees, whether written or oral, under which the entity is contingently liable.

n. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*.

o. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the interim financial information or as a basis for recording a loss contingency.

p. Unasserted claims or assessments that are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*.

q. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.

r. Satisfactory title to all owned assets, liens or encumbrances on such assets, and assets pledged as collateral.

s. Compliance with aspects of contractual agreements that may affect the interim financial information.

⁹ If a summary of uncorrected misstatements is unnecessary because there were no uncorrected misstatements identified, this representation should be eliminated.

Subsequent Events

t. Information concerning subsequent events.

The representation letter ordinarily should be tailored to include additional representations from management related to matters specific to the entity's business or industry. Appendix C of this Statement presents illustrative representation letters.

22. *Inquiry concerning litigation, claims, and assessments.* A review of interim financial information does not contemplate obtaining corroborating evidential matter for responses to inquiries concerning litigation, claims, and assessments (see paragraph 7). Consequently, it ordinarily is not necessary to send an inquiry letter to an entity's lawyer concerning litigation, claims, and assessments. However, if information comes to the accountant's attention that leads him or her to question whether the interim financial information departs from generally accepted accounting principles¹⁰ with respect to litigation, claims, or assessments, and the accountant believes the entity's lawyer may have information concerning that question, an inquiry of the lawyer concerning the specific question is appropriate.

23. *Inquiry concerning an entity's ability to continue as a going concern.* A review of interim financial information is not designed to identify conditions or events that may indicate substantial doubt about an entity's ability to continue as a going concern. However, such conditions or events may have existed at the date of prior-period financial statements.¹¹ In addition, in the course of performing review procedures on the current-period interim financial information, the accountant may become aware of conditions or events that might be indicative of the entity's possible inability to continue as a going concern. In either case, the accountant should (a) inquire of management as to its plans for dealing with the adverse effects of the conditions and events, and (b) consider the adequacy of the disclosure about such matters in the interim financial information.¹² It ordinarily is not necessary for the accountant to obtain evidential matter in support of the information that mitigates the effects of the conditions and events.

24. *Extension of interim review procedures.* If, in performing a review of interim financial information, the accountant becomes aware of information that leads him or her to believe that the interim financial information may not conform with generally accepted accounting principles in all material respects, the accountant should make additional inquiries or perform other procedures that the accountant considers appropriate to provide a basis for communicating whether he or she is aware of any material modifications that should be made to the interim financial information. For example, if the accountant's interim review procedures lead him or her to question whether a significant sales transaction is recorded in conformity with generally accepted accounting principles, the accountant should perform additional procedures, such as

¹⁰ In accordance with APB Opinion No. 28, contingencies and other uncertainties that could be expected to affect the fairness of the presentation of financial data at an interim date should be disclosed in interim reports in the same manner required for annual reports. Such disclosures should be repeated in interim and annual reports until the contingencies have been removed, resolved, or become immaterial. The significance of a contingency or uncertainty should be judged in relation to annual financial statements.

¹¹ For purposes of this Statement, "such conditions and events that existed at the date of prior-period financial statements" include (a) substantial doubt about the entity's ability to continue as a going concern that existed at the preceding annual period, regardless of whether the substantial doubt was alleviated by the auditor's consideration of management's plans, or (b) conditions and events disclosed in the immediately preceding interim period.

¹² Information that might be disclosed is set forth in SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec.341.10). If the accountant determines that the disclosure about the entity's possible inability to continue as a going concern is inadequate, a departure from generally accepted accounting principles exists.

discussing the terms of the transaction with senior marketing and accounting personnel and/or reading the sales contract, to resolve his or her questions.

EVALUATING THE RESULTS OF INTERIM REVIEW PROCEDURES

25. A review of interim financial information is not designed to obtain reasonable assurance that the interim financial information is free of material misstatement. However, based on the review procedures performed, the accountant may become aware of *likely misstatements*.¹³ In the context of an interim review, a likely misstatement is the accountant's best estimate of the total misstatement in the account balances or classes of transactions on which he or she has performed review procedures. The accountant should accumulate for further evaluation likely misstatements identified in performing the review procedures. The accountant may designate an amount below which misstatements need not be accumulated, based on his or her professional judgment. However, the accountant should recognize that aggregated misstatements of relatively small amounts could have a material effect on the interim financial information.

26. Misstatements identified by the accountant or brought to the accountant's attention, including inadequate disclosure,¹⁴ should be evaluated individually and in the aggregate to determine whether material modification should be made to the interim financial information for it to conform with generally accepted accounting principles.¹⁵ The accountant should use his or her professional judgment in evaluating the materiality of any likely misstatements that the entity has not corrected. The accountant should consider matters such as (a) the nature, cause (if known), and amount of the misstatements identified in the preceding year or interim periods of the current

¹³ The term *likely misstatement* is defined in SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312.34), as the auditor's best estimate of the total misstatement in the account balances or classes of transactions that he or she has examined. Likely misstatement includes specifically identified misstatements.

¹⁴ Rule 10-01 of Regulation S-X states, in part,—

The interim financial information shall include disclosures either on the face of the financial statements or in accompanying footnotes sufficient so as to make the interim information presented not misleading. Registrants may presume that users of the interim financial information have read or have access to the audited financial statements for the preceding fiscal year and that the adequacy of additional disclosure needed for a fair presentation, except in regard to material contingencies, may be determined in that context. Accordingly, footnote disclosure which would substantially duplicate the disclosure contained in the most recent annual report to security holders or latest audited financial statements, such as a statement of significant accounting policies and practices, details of accounts which have not changed significantly in amount or composition since the end of the most recently completed fiscal year, and detailed disclosures prescribed by Rule 408 of this Regulation, may be omitted. However, disclosure shall be provided where events subsequent to the end of the most recent fiscal year have occurred which have a material impact on the registrant.

¹⁵ APB Opinion No. 28 describes the applicability of generally accepted accounting principles to interim financial information and indicates the types of disclosures necessary to report on a meaningful basis for a period of less than a full year. Paragraph 29 of Opinion No. 28 further provides additional guidance on assessing materiality in interim periods. For example, the Opinion states, "In determining materiality for the purpose of reporting the cumulative effect of an accounting change or correction of an error, amounts should be related to the estimated income for the full fiscal year and also to the effect on the trend of earnings."

year and corresponding prior year, and (b) materiality judgments made in conjunction with the current or prior year's annual audit.¹⁶

27. When evaluating whether uncorrected likely misstatements, individually or in the aggregate, are material, the accountant should (a) consider the appropriateness of offsetting a misstatement of an estimated amount with a misstatement of an item capable of precise measurement, and (b) recognize that an accumulation of immaterial misstatements in the balance sheet could contribute to material misstatements in future periods.

COMMUNICATIONS TO MANAGEMENT, AUDIT COMMITTEES, AND OTHERS

28. As a result of conducting a review of interim financial information, the accountant may become aware of matters that cause him or her to believe that (a) material modification should be made to the interim financial information for it to conform with generally accepted accounting principles, or (b) that the entity filed the Form 10-Q or Form 10-QSB before the completion of the review. In such circumstances, the accountant should communicate the matter(s) to the appropriate level of management as soon as practicable.

29. If, in the accountant's judgment, management does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should inform the audit committee or others with equivalent authority and responsibility (hereafter referred to as the audit committee) of the matters as soon as practicable. This communication may be oral or written. If information is communicated orally, the accountant should document the communication.

30. If, in the accountant's judgment, the audit committee does not respond appropriately to the accountant's communication within a reasonable period of time, the accountant should evaluate whether to resign from the engagement to review the interim financial information and as the entity's auditor. The accountant may wish to consult with his or her attorney when making these evaluations.

31. When conducting a review of interim financial information, the accountant may become aware of fraud or possible illegal acts. If the matter involves fraud, it should be brought to the attention of the appropriate level of management. If the fraud involves senior management or results in a material misstatement of the financial statements, the accountant should communicate the matter directly to the audit committee as described in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316.38). If the matter involves possible illegal acts, the accountant should assure himself or herself that the audit committee is adequately informed, unless the matter is clearly inconsequential.¹⁷ (See SAS No. 54, *Illegal Acts by Clients* [AICPA, *Professional Standards*, vol. 1, AU sec. 317.17].)

32. When conducting a review of interim financial information, the accountant may become aware of matters relating to internal control that may be of interest to the audit committee. Matters that should be reported to the audit committee are referred to as reportable conditions.

¹⁶ Interpretation No. 4, "Considering the Qualitative Characteristics of Misstatements," of SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 312), provides additional guidance on evaluating whether misstatements are material.

¹⁷ The accountant may have additional communication responsibilities pursuant to SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards*, vol. 1, AU sec. 317); Section 10A of the Securities Exchange Act of 1934; and SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316).

Reportable conditions are matters coming to the accountant's attention that, in his or her judgment, should be communicated to the audit committee because they represent significant deficiencies in the design or operation of internal control that could adversely affect the organization's ability to initiate, record, summarize, and report financial data consistent with management's assertions in the interim financial information. The accountant also may wish to submit recommendations related to other matters that come to the accountant's attention.¹⁸

33. When conducting a review of interim financial information, the accountant also should determine whether any of the matters described in SAS No. 61, *Communication With Audit Committees* (AICPA, *Professional Standards*, vol. 1, AU sec. 380), as they relate to the interim financial information, have been identified. If such matters have been identified, the accountant should communicate them to the audit committee or be satisfied, through discussion with the audit committee, that such matters have been communicated to the audit committee by management. For example, the accountant should determine that the audit committee is informed about the process used by management to formulate particularly sensitive accounting estimates, about a change in a significant accounting policy affecting the interim financial information, and about uncorrected misstatements aggregated by the accountant that were determined by management to be immaterial, both individually and in the aggregate, to the interim financial statements taken as a whole.¹⁹

34. The objective of a review of interim financial information differs significantly from that of an audit. Therefore, any communication the accountant may make about the quality, not just the acceptability, of the entity's accounting principles as applied to its interim financial reporting generally would be limited to the effect of significant events, transactions, and changes in accounting estimates that the accountant considered when conducting the review of interim financial information. Further, interim review procedures do not provide assurance that the accountant will become aware of all matters that might affect the accountant's judgments about the quality of the entity's accounting principles that would be identified as a result of an audit.

35. If the accountant has identified matters to be communicated to the audit committee, the accountant should attempt to make such communications with the audit committee, or at least its chair, and a representative of management before the entity files its interim financial information with a regulatory agency (such as the SEC). If such communications cannot be made before the filing, they should be made as soon as practicable in the circumstances. The communications may be oral or written. If information is communicated orally, the accountant should document the communications.

THE ACCOUNTANT'S REPORT ON A REVIEW OF INTERIM FINANCIAL INFORMATION²⁰

Form of Accountant's Review Report

36. The accountant's review report accompanying interim financial information should consist of:

¹⁸ SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325), provides guidance on communicating reportable conditions related to internal control.

¹⁹ The presentation to the audit committee should be similar to the summary of uncorrected misstatements included in or attached to the management representation letter that is described in paragraph 21(g) of this Statement.

²⁰ Paragraphs 36 through 45 of this Statement provide reporting guidance for a review of interim financial information; however, an accountant is not required to issue a report on such engagements.

- a. A title that includes the word *independent*.
- b. A statement that the interim financial information identified in the report was reviewed.
- c. A statement that the interim financial information is the responsibility of the entity's management.
- d. A statement that the review of interim financial information was conducted in accordance with standards established by the AICPA.
- e. A description of the procedures for a review of interim financial information.
- f. A statement that a review of interim financial information is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is an expression of an opinion regarding the financial statements taken as a whole, and accordingly, no such opinion is expressed.
- g. A statement about whether the accountant is aware of any material modifications that should be made to the accompanying interim financial information for it to conform with generally accepted accounting principles. The statement should include an identification of the country of origin of those accounting principles (for example, accounting principles generally accepted in the United States of America or U.S. generally accepted accounting principles).
- h. The manual or printed signature of the accountant's firm.
- i. The date of the review report. (Generally, the report should be dated as of the date of completion of the review procedures.²¹)

In addition, each page of the interim financial information should be clearly marked as unaudited.

37. The following is an example of a review report.²²

Independent Accountant's Report

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and consolidated subsidiaries as of September 30, 20XX, and for the three-month and nine-month periods then ended. This (These) financial information (statements) is (are) the responsibility of the company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally

²¹ Other reporting issues related to the dating of reports or subsequent events are similar to those encountered in an audit of financial statements. See SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 530, "Dating of the Independent Auditor's Report," and AU sec. 560, "Subsequent Events").

²² If interim financial information of a prior period is presented with that of the current period and the accountant has conducted a review of that information, the accountant should report on his or her review of the prior period. An example of the first sentence of such a report follows: "We have reviewed ... of ABC Company and consolidated subsidiaries as of September 30, 20X1 and 20X2, and for the three-month and nine-month periods then ended...."

accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial information (statements) for it (them) to be in conformity with accounting principles generally accepted in the United States of America.

[Signature]

[Date]

38. An accountant may report on a review of comparative interim financial information. The following is an example of a review report on a condensed balance sheet as of March 31, 20X1, the related condensed statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0, and a condensed balance sheet derived from audited financial statements as of December 31, 20X0, that were included in Form 10-Q.²³

Independent Accountant's Report

We have reviewed the condensed consolidated balance sheet of ABC Company and subsidiaries as of March 31, 20X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 20X1 and 20X0. These financial statements are the responsibility of the company's management.

We conducted our review in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States of America.

²³ Regulation S-X specifies that the following financial information should be provided in filings on Form 10-Q:

- a. An interim balance sheet as of the end of the most recent fiscal quarter and a balance sheet as of the end of the preceding fiscal year that may be condensed to the same extent as the interim balance sheet.
- b. Interim condensed statements of income for the most recent fiscal quarter, for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter, and for the corresponding periods of the preceding fiscal year.
- c. Interim condensed cash flow statements for the period between the end of the preceding fiscal year and the end of the most recent fiscal quarter and for the corresponding period for the preceding fiscal year.

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated balance sheet as of December 31, 20X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 20X1, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 20X0, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.²⁴

[Signature]

[Date]

39. The accountant may use and make reference to another accountant's review report on the interim financial information of a significant component of a reporting entity. This reference indicates a division of responsibility for performing the review.²⁵ The following is an example of report including such a reference:

Independent Accountant's Report

We have reviewed the accompanying [*describe the interim financial information or statements reviewed*] of ABC Company and consolidated subsidiaries as of September 30, 20XX, and for the three-month and nine-month periods then ended. This (These) financial information (statements) is (are) the responsibility of the company's management.

We were furnished with the report of other accountants on their review of the interim financial information of DEF subsidiary, whose total assets as of September 30, 20XX, and whose revenues for the three-month and nine-month periods then ended, constituted 15 percent, 20 percent, and 22 percent, respectively, of the related consolidated totals.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information (statements) consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to the accompanying interim

²⁴ If the auditor's report on the complete year-end financial statements was other than unqualified, referred to other auditors, or included an explanatory paragraph because of a going-concern matter or an inconsistency in the application of accounting principles, the last paragraph of the illustrative report in paragraph 38 should be appropriately modified. Modification also would be required if the year-end financial statements had been audited by another auditor.

²⁵ See SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 543, "Part of Audit Performed by Other Independent Auditors").

financial information (statements) for it (them) to be in conformity with accounting principles generally accepted in the United States of America.

[Signature]

[Date]

Modification of the Accountant's Review Report

40. The accountant's report on a review of interim financial information should be modified for departures from generally accepted accounting principles,²⁶ which include inadequate disclosure and changes in accounting principle that are not in conformity with generally accepted accounting principles. The existence of substantial doubt about the entity's ability to continue as a going concern or a lack of consistency in the application of accounting principles affecting the interim financial information would not require the accountant to add an additional paragraph to the report, provided that the interim financial information appropriately discloses such matters. Although not required, the accountant may wish to emphasize such matters in a separate explanatory paragraph of the report. See paragraphs 43 and 44 for examples of paragraphs that address matters related to an entity's ability to continue as a going concern.

41. *Departure from generally accepted accounting principles.* If the accountant becomes aware that the interim financial information is materially affected by a departure from generally accepted accounting principles, he or she should modify the report. The modification should describe the nature of the departure and, if practicable, should state the effects on the interim financial information. Following is an example of such a modification of the accountant's report.

[Explanatory third paragraph]

Based on information furnished to us by management, we believe that the company has excluded from property and debt in the accompanying balance sheet certain lease obligations that we believe should be capitalized to conform with accounting principles generally accepted in the United States of America. This information indicates that if these lease obligations were capitalized at September 30, 20XX, property would be increased by \$_____, long-term debt by \$_____, and net income and earnings per share would be increased (decreased) by \$_____, \$_____, \$_____, and \$_____, respectively, for the three-month and nine-month periods then ended.

[Concluding paragraph]

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying financial information (statements) for it (them) to be in conformity with accounting principles generally accepted in the United States of America.

42. *Inadequate disclosure.* The information necessary for adequate disclosure is influenced by the form and context in which the interim financial information is presented. For example, the disclosures considered necessary for interim financial information presented in accordance with the minimum disclosure requirements of APB Opinion No. 28, paragraph 30 [AC section 173.146]

²⁶ If the circumstances contemplated by Rule 203 are present, the accountant should refer to the guidance in SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508.15).

which is applicable to summarized financial statements of public companies, are considerably less extensive than those necessary for annual financial statements that present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.²⁷ If information that the accountant believes is necessary for adequate disclosure in conformity with generally accepted accounting principles²⁸ is not included in the interim financial information, the accountant should modify the report and, if practicable, include the necessary information in the report. The following is an example of such a modification of the accountant's report:

[Explanatory third paragraph]

Management has informed us that the company is presently contesting deficiencies in federal income taxes proposed by the Internal Revenue Service for the years 20XX through 20XY in the aggregate amount of approximately \$_____, and that the extent of the company's liability, if any, and the effect on the accompanying statements (information) are (is) not determinable at this time. The statements (information) fail(s) to disclose these matters, which we believe are required to be disclosed in conformity with accounting principles generally accepted in the United States of America.

[Concluding paragraph]

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying interim financial information (statements) for it (them) to be in conformity with accounting principles generally accepted in the United States of America.

43. *Going-concern paragraph was included in the prior year's audit report; conditions giving rise to the paragraph continue to exist.* If (a) the auditor's report for the prior year end contained an explanatory paragraph indicating the existence of substantial doubt about the entity's ability to continue as a going concern, (b) the conditions that raised such doubt continued to exist as of the interim reporting date covered by the review, and (c) there is adequate and appropriate disclosure about these conditions in the interim financial information, the accountant is not required to modify his or her report. However, the accountant may add an explanatory paragraph to the review report, after the concluding paragraph, emphasizing the matter disclosed in the audited financial statements and the interim financial information. The following is an example of such a paragraph.

Note 4 of the Company's audited financial statements as of December 31, 20X1, and for the year then ended discloses that the Company was unable to renew its line of credit or obtain alternative financing at December 31, 20X1. Our auditor's report on those financial statements includes an explanatory paragraph referring to the matters in Note 4 of those financial statements and indicating that these

²⁷ APB Opinion No. 28, paragraph 32, states that "there is a presumption that users of summarized interim financial data will have read the latest published annual report, including the financial disclosures required by generally accepted accounting principles and management's commentary concerning the annual financial results, and that the summarized interim data will be viewed in that context." See footnote 14 of this Statement for additional disclosure requirements.

²⁸ Such disclosures include those set forth in SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU sec. 341.10). If the accountant determines that disclosure about the entity's possible inability to continue as a going concern is inadequate, a departure from generally accepted accounting principles exists.

matters raised substantial doubt about the Company's ability to continue as a going concern. As indicated in Note 3 of the Company's unaudited interim financial statements as of March 31, 20X2, and for the three months then ended, the Company was still unable to renew its line of credit or obtain alternative financing as of March 31, 20X2. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

44. *Going-concern paragraph was not included in the prior year's audit report; conditions that may raise doubt about the entity's ability to continue as a going concern exist at the end of the quarter being reviewed.* If (a) conditions that raise doubt about the entity's ability to continue as a going concern exist as of the interim reporting date covered by the review, and (b) there is adequate and appropriate disclosure about these conditions in the interim financial information, the accountant is not required to modify his or her report. However, the accountant may add an explanatory paragraph to the review report, after the concluding paragraph, emphasizing the matter disclosed in the interim financial information. The following is an example of such a paragraph.

As indicated in Note 3, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying interim financial information does not include any adjustments that might result from the outcome of this uncertainty.

Subsequent Discovery of Facts Existing at the Date of the Accountant's Report

45. Subsequent to the date of the accountant's review report or the completion of the interim review procedures (if a report is not issued), the accountant may become aware that facts existed at the date of the review report (or the completion of the review procedures) that might have affected the accountant's report had he or she then been aware of those matters. Because of the variety of conditions that might be encountered, the specific actions to be taken by the accountant in a particular case may vary with the circumstances. In any event, the accountant should consider the guidance in SAS No. 1 (AICPA, *Professional Standards*, vol. 1, AU sec. 561, "Subsequent Discovery of Facts Existing at the Date of the Auditor's Report").

CLIENT'S REPRESENTATION CONCERNING A REVIEW OF INTERIM FINANCIAL INFORMATION

46. If a client represents in a document filed with a regulatory agency (see paragraph 3 for the SEC requirement) or issued to stockholders or third parties, that the accountant has reviewed the interim financial information included in the document, the accountant should advise the entity that his or her review report must be included in the document. If the client will not agree to include the accountant's review report or if the accountant has been unable to complete the review, the accountant should perform the following procedures.

- Request that the accountant's name be neither associated with the interim financial information nor referred to in the document.
- If the client does not comply with the request, advise the client that the accountant will not consent either to the use of his or her name or to reference to him or her.
- When appropriate, recommend that the client consult with its legal counsel about the application of relevant laws and regulations to the circumstances.

- Consider what other actions might be appropriate.²⁹

INTERIM FINANCIAL INFORMATION ACCOMPANYING AUDITED FINANCIAL STATEMENTS

47. Interim financial information may be presented as supplementary information outside audited financial statements. In such circumstances, each page of the interim financial information should be clearly marked as unaudited. If management chooses or is required to present interim financial information in a note to the audited financial statements, the information also should be clearly marked as unaudited.

48. The auditor ordinarily need not modify his or her report on the audited financial statements to refer to his or her having performed a review in accordance with this Statement or to refer to the interim financial information accompanying the audited financial statements because the interim financial information has not been audited and is not required for the audited financial statements to be fairly stated in conformity with generally accepted accounting principles. The auditor's report on the audited financial statements should, however, be modified in the following circumstances:

a. The interim financial information included in a note to the financial statements, including information that has been reviewed in accordance with this Statement, is not appropriately marked as unaudited. (In these circumstances the auditor should disclaim an opinion on the interim financial information.)

b. The interim financial information accompanying audited financial statements does not appear to be presented in conformity with generally accepted accounting principles (see paragraphs 41 and 42). However, the auditor need not modify his or her report on the audited financial statements if his or her separate review report, which refers to those circumstances, is presented with the information.

DOCUMENTATION

49. The accountant should prepare documentation in connection with a review of interim financial information, 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.³⁰ Examples of documentation are review programs, analyses, memoranda, and letters of representation. Documentation may be in paper or electronic form, or other media. The quantity, type, and content of the documentation are matters of the accountant's professional judgment.

50. Because of the different circumstances in individual engagements, it is not possible to specify the form or content of the documentation the accountant should prepare. 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 that the interim financial information could be materially misstated, including actions taken to address such findings, and the basis for the final conclusions reached. In addition, the documentation should (a) enable members of the engagement team with supervision and review responsibilities to understand the

²⁹ In considering what actions, if any, may be appropriate in these circumstances, the accountant should consider consulting his or her legal counsel.

³⁰ However, an accountant would not be precluded from supporting his or her conclusions by other means in addition to the documentation.

nature, timing, extent, and results of the review procedures performed, (b) identify the engagement team member(s) who performed and reviewed the work, and (c) identify the evidence the accountant obtained in support of the conclusion that the interim financial information to be reported on agreed or reconciled with the accounting records (see paragraph 20d).

EFFECTIVE DATE

51. This Statement is effective for interim periods within fiscal years beginning after December 15, 2002. Earlier application of the provisions of this Statement is permitted.

APPENDIX A

ANALYTICAL PROCEDURES THE ACCOUNTANT MAY CONSIDER PERFORMING WHEN CONDUCTING A REVIEW OF INTERIM FINANCIAL INFORMATION

Analytical procedures are designed to identify relationships and individual items that appear to be unusual and that may reflect a material misstatement of the interim financial information. These procedures may consist of comparing interim financial information with prior period information, actual interim results with anticipated results (such as budgets or forecasts), and recorded amounts or ratios with expectations developed by the accountant. Examples of analytical procedures the accountant may consider performing in a review of interim financial information include:

- Comparing current interim 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 interim financial information with corresponding information in (a) budgets, using expected rates, and (b) financial information for prior periods).¹
- Comparing current interim financial information with relevant nonfinancial information.
- Comparing ratios and indicators for the current interim period with expectations based on prior periods, for example, performing gross profit analysis by product line and business segment using elements of the current interim 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 interim period with those of entities in the same industry.
- Comparing relationships among elements in the current interim financial information with corresponding relationships in the interim 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.
- Comparing disaggregated data. The following are examples of how data may be disaggregated.
 - By period, for example, revenue or expense items disaggregated into quarterly, monthly, or weekly amounts.
 - By product line or source of revenue.
 - By location, for example, subsidiary, division, or branch.

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

- By attributes of the transaction, for example, revenue generated by designers, architects, or craftsmen.
- By several attributes of the transaction, for example, sales by product and month.

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

APPENDIX B

UNUSUAL OR COMPLEX SITUATIONS TO BE CONSIDERED BY THE ACCOUNTANT WHEN CONDUCTING A REVIEW OF INTERIM FINANCIAL INFORMATION

The following are examples of situations about which the accountant would ordinarily inquire of management:

- Business combinations
- New or complex revenue recognition methods
- Impairment of assets
- Disposal of a segment of a business
- Use of derivative instruments and hedging activities
- Sales and transfers that may call into question the classification of investments in securities, including management's intent and ability with respect to the remaining securities classified as held to maturity
- Computation of earnings per share in a complex capital structure
- Adoption of new stock compensation plans or changes to existing plans
- Restructuring charges taken in the current and prior quarters
- Significant, unusual, or infrequently occurring transactions
- Changes in litigation or contingencies
- Changes in major contracts with customers or suppliers
- Changes in accounting principles or the methods of applying them
- Trends and developments affecting accounting estimates,¹ such as allowances for bad debts and excess or obsolete inventories, provisions for warranties and employee benefits, and realization of unearned income and deferred charges
- Compliance with debt covenants
- Changes in related parties or significant new related-party transactions

¹ The accountant may wish to refer to the guidance in Statement on Auditing Standards No. 57, *Auditing Accounting Estimates* (AICPA, *Professional Standards*, vol. 1, AU sec. 342.05 and .06).

APPENDIX C

ILLUSTRATIVE MANAGEMENT REPRESENTATION LETTERS FOR A REVIEW OF INTERIM FINANCIAL INFORMATION

1. The following illustrative management representation letters, which relate to a review of interim financial information prepared in conformity with generally accepted accounting principles, are presented for illustrative purposes only. The first letter may be used independently of any other representation letter. The second illustrative representation letter is designed to be used in conjunction with the representation letter provided by management in connection with the audit of the financial statements of the prior year end.
2. The introductory paragraph of the letters should specify the financial statements and periods covered by the accountant's report, for example, "balance sheets of XYZ Company as of June 30, 20X1 and 20X2, and the related statements of income and retained earnings and cash flows for the three-month and nine-month periods then ended." The written representations to be obtained should be based on the circumstances of the engagement and the nature and basis of presentation of the financial statements being reviewed. Appendix B, "Additional Illustrative Representations," of Statement on Auditing Standards (SAS) No. 85, *Management Representations* (AICPA, *Professional Standards*, vol. 1, AU sec 333.17), presents examples of such representations. Illustrative representations for specialized industries are presented in AICPA Audit and Accounting Guides.
3. If matters exist that should be disclosed to the accountant, they should be indicated by modifying the related representation. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, the final paragraph could be modified as follows: "To the best of our knowledge and belief, except as discussed in note X to the financial statements, no events have occurred. . . ." In appropriate circumstances, item 9 of the first illustrative representation letter could be modified as follows: "The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except for our plans to dispose of segment A, as disclosed in note X to the interim financial information, which are discussed in the minutes of the June 7, 20X2, meeting of the board of directors (or disclosed to you at our meeting on June 15, 20X2)."
4. The qualitative discussion of materiality used in the illustrative letters is adapted from the Financial Accounting Standards Board Statement of Financial Accounting Concepts No. 2, *Qualitative Characteristics of Accounting Information*.
5. Certain terms are used in the illustrative letters that are described elsewhere in authoritative literature. Examples are *fraud*, in SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), and *related parties*, in SAS No. 45, *Related Parties* (AICPA, *Professional Standards* vol. 1, AU sec. 334, footnote 1). To avoid misunderstanding concerning the meaning of such terms, the accountant may wish to furnish those definitions to management or request that the definitions be included in the written representations.
6. The illustrative letters assume that management and the accountant have reached an understanding on the limits of materiality for purposes of the written representations. However, it should be noted that a materiality limit would not apply for certain representations, as explained in SAS No. 85 (AU sec. 333.08).

1. Illustrative Representation Letter for a Review of Interim Financial Information (Statements)

[Date]

To [Independent Accountant]

We are providing this letter in connection with your review of the [identification of financial information (statements)] of [name of entity] as of [dates] and for the [periods] for the purpose of determining whether any material modifications should be made to the [consolidated] financial information (statements) for it (them) to conform with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the [consolidated] financial information (statements) of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, [as of (date of accountant's report or the completion of the review)], the following representations made to you during your review.

1. The unaudited interim financial information (statements) referred to above has (have) been prepared and presented in conformity with generally accepted accounting principles applicable to interim financial information (statements).
2. We have made available to you—
 - a. All financial records and related data.
 - b. All minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared. All significant board and committee actions are included in the summaries.
3. There have been no communications from regulatory agencies concerning noncompliance with or deficiencies in financial reporting practices.
4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial information.
5. We believe that the effects of any uncorrected financial information (statements) misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the interim financial information (statements) taken as a whole.¹
6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

¹ If a summary of uncorrected misstatements is unnecessary because no uncorrected misstatements were identified, this representation should be eliminated.

7. We have no knowledge of any fraud that has been perpetrated on the company or any alleged or suspected fraud involving:

- a. Management;
- b. Employees who have significant roles in the financial reporting process; or
- c. Others, where the fraud could have a material effect on the interim financial information.

8. We have no knowledge of any allegations of fraudulent financial reporting on the part of the company received in communications from employees, former employees, short sellers, financial analysts, or others.

9. The company has no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.

10. The following have been properly recorded or disclosed in the financial information (statements):

- a. Related-party transactions, including sales, purchases, loans, transfers, leasing arrangements, and guarantees, and amounts receivable from or payable to related parties.
- b. Guarantees, whether written or oral, under which the company is contingently liable.
- c. Significant estimates and material concentrations known to management that are required to be disclosed in accordance with the AICPA's Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. [*Significant estimates are estimates at the balance sheet date that could change materially within the next year. Concentrations refer to volumes of business, revenues, available sources of supply, or markets or geographic areas for which events could occur that would significantly disrupt normal finances within the next year.*]

11. There are no:

- a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the interim financial information (statements) or as a basis for recording a loss contingency.
- b. Unasserted claims or assessments that are probable of assertion and must be disclosed in accordance with Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.
- c. Other liabilities or gain or loss contingencies that are required to be accrued or disclosed by FASB Statement No. 5.

12. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets, nor has any asset been pledged as collateral.

13. The company has complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

14. *[Add additional representations that are unique to the entity's business or industry. See paragraph 21 of this Statement and Statement on Auditing Standards No. 85, Management Representations (AICPA, Professional Standards, vol. 1, AU sec. 333.17).]*

15. *[Add any representations related to new accounting or auditing standards that are being implemented for the first time.]*

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial information (statements).

[Name of chief executive officer and title]

[Name of chief financial officer and title]

[Name of chief accounting officer and title]

2. Illustrative Short-Form Representation Letter for a Review of Interim Financial Information (Statements)

[This representation letter is to be used in conjunction with the representation letter for the audit of the financial statements of the prior year end. Management confirms the representations made in the representation letter for the audit of the financial statements of the prior year end that are applicable to the interim review and makes additional representations that may be needed for the interim financial information.]

[Date]

To [*Independent Accountant*]:

We are providing this letter in connection with your review of the [*identification of financial information (statements)*] of [*name of entity*] as of [*dates*] and for the [*periods*] for the purpose of determining whether any material modifications should be made to the [*consolidated*] financial information (statements) for it (them) to conform with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the [*consolidated*] financial information (statements) of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, [*as of (date of accountant's report or completion of review),*] the following representations made to you during your review.

1. The unaudited interim financial information (statements) referred to above has (have) been prepared and presented in conformity with generally accepted accounting principles applicable to interim financial information.
2. We have made available to you:
 - a. All financial records and related data.
 - b. All minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared. All significant board and committee actions are included in the summaries.
3. We believe that the effects of any uncorrected financial information (statement) misstatements summarized in the accompanying schedule are immaterial, both individually and in the aggregate, to the financial information (statements) taken as a whole.¹
4. We have reviewed our representation letter to you dated (date of representation letter relating to most recent audit) with respect to the audited financial statements for the year ended (prior year-end date). We now confirm those representations 1 through X, which, to the degree

¹ If a summary of uncorrected misstatements is unnecessary because no uncorrected misstatements were identified, this representation should be eliminated.

appropriate, apply to the interim financial information (statements) referred to above, and incorporate them herein, with the following changes:

[Indicate any changes]

5. *[Add any representations related to new accounting or auditing standards that are being implemented for the first time.]*

To the best of our knowledge and belief, no events have occurred subsequent to the balance-sheet date and through the date of this letter that would require adjustment to or disclosure in the aforementioned financial information (statements).

[Name of chief executive officer and title]

[Name of chief financial officer and title]

[Name of chief accounting officer and title]