

Appendix B

Review of Financial Statements—Illustrative Inquiries

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

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

1. General

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

g. Are any entities, other than the reporting entity, commonly controlled by the owners? If so, has an evaluation been performed to determine whether those other entities should be consolidated into the financial statements of the reporting entity?

h. Are there any entities other than the reporting entity in which the owners have significant investments (for example, variable interest entities)? If so, has an evaluation been performed to determine whether the reporting entity is the primary beneficiary related to the activities of these other entities?

i. Is the reporting entity a general partner in a limited partnership arrangement? If so, has an evaluation been performed to determine whether the limited partnership should be consolidated into the financial statements of the reporting entity?

j. Is the reporting entity a controlling partner in a general partnership arrangement? If so, has an evaluation been performed to determine whether the partnership should be consolidated into the financial statements of the controlling partner?

ki. Have any significant transactions occurred or been recognized near the end of the reporting period?

2. Cash and cash equivalents

a. Is the entity's policy regarding the composition of cash and cash equivalents in accordance with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 95, Statement of Cash Flows (paragraphs 7–10)? Has the policy been applied on a consistent basis?

b. Are all cash and cash equivalents [fn.1](#) accounts reconciled on a timely basis?

c. Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made where necessary?

d. Has there been a proper cutoff of cash receipts and disbursements?

e. Has a reconciliation of intercompany transfers been prepared?

f. Have checks written but not mailed as of the financial statement date been properly reclassified into the liability section of the balance sheet?

g. Have material bank overdrafts been properly reclassified into the liability section of the balance sheet?

h. Are there compensating balances or other restrictions on the availability of cash and cash equivalents balances? If so, has consideration been given to reclassifying these amounts as noncurrent assets?

i. Have cash funds been counted and reconciled with control accounts?

3. Receivables

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

b. Have uncollectible receivables been written off through a charge against the allowance account or earnings?

c. Has interest earned on receivables been properly reflected in the financial statements?

d. Has there been a proper cutoff of sales transactions?

e. Are there receivables from employees or other related parties? Have receivables from owners been evaluated to determine if they should be reflected in the equity section (rather than the asset section) of the balance sheet?

f. Are any receivables pledged, discounted, or factored? Are recourse provisions properly reflected in the financial statements?

g. Have receivables been properly classified between current and noncurrent?

h. Have there been significant numbers of sales returns or credit memoranda issued subsequent to the balance sheet date?

i. Is the accounts receivable subsidiary ledger reconciled to the general ledger account balance on a regular basis?

4. Inventory

a. Are physical inventory counts performed on a regular basis, including at the end of the reporting period? Are the count procedures adequate to ensure an appropriate count? If not, how have amounts related to inventories been determined for purposes of financial statement presentation? If so, what procedures were used to take the latest physical inventory and what date was that inventory taken?

b. Have general ledger control accounts been adjusted to agree with the physical inventory count? If so, were the adjustments significant?

c. If the physical inventory counts were taken at a date other than the balance sheet date, what procedures were used to determine changes in inventory between the date of the physical inventory counts and the balance sheet date?

d. Were consignments in or out considered in taking physical inventories?

- e. What is the basis of valuing inventory for purposes of financial statement presentation?
- f. Does inventory cost include material, labor, and overhead where applicable?
- g. Has inventory been reviewed for obsolescence or cost in excess of net realizable value? If so, how are these costs reflected in the financial statements?
- h. Have proper cutoffs of purchases, goods in transit, and returned goods been made?
- i. Are there any inventory encumbrances?
- j. Is scrap inventoried and controlled?
- k. *Have abnormal costs related to inventory been expensed as incurred?***

5. Prepaid Expenses

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

6. Investments

- a. What is the basis of accounting for investments reported in the financial statements (for example, securities, joint ventures, or closely-held businesses)?
- b. Are derivative instruments properly measured and disclosed in the financial statements? If those derivatives are utilized in hedge transactions, have the documentation or assessment requirements related to hedge accounting been met?
- c. Are investments in marketable debt and equity securities properly classified as trading, available-for-sale, and held-to-maturity?
- d. How were fair values of the reported investments determined? Have unrealized gains and losses been properly reported in the financial statements?
- e. If the fair values of marketable debt and equity securities are less than cost, have the declines in value been evaluated to determine whether the declines are other-than-temporary?
- f. For any debt securities classified as held-to-maturity, does management have the positive ability and intent to hold the securities until they mature? If so, have those debt securities been properly measured?

- g. Have gains and losses related to disposal of investments been properly reflected in the financial statements?
- h. How was investment income determined? Is investment income properly reflected in the financial statements?
- i. Has appropriate consideration been given to the classification of investments between current and noncurrent?
- j. For investments made by the reporting entity, have consolidation, equity, or cost method accounting requirements been considered?
- k. Are any investments encumbered?

7. Property and Equipment

- a. Are property and equipment items properly stated at depreciated cost or other proper value?
- b. When was the last time a physical inventory of property and equipment was taken?
- c. Are all items reflected in property and equipment held for use? If not, have items that are held for sale been properly reclassified from property and equipment?
- d. Have gains or losses on disposal of property and equipment been properly reflected in the financial statements?
- e. What are the criteria for capitalization of property and equipment? Have the criteria been consistently and appropriately applied?
- f. Are repairs and maintenance costs properly reflected as an expense in the income statement?
- g. What depreciation methods and rates are utilized in the financial statements? Are these methods and rates appropriate and applied on a consistent basis?
- h. Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?
- i. Does the entity have any material lease agreements? If so, have those agreements been properly evaluated for financial statement presentation purposes?
- j. Are there any asset retirement obligations associated with tangible long-lived assets? If so, has the recorded amount of the related asset been increased because of the obligation and is the liability properly reflected in the liability section of the balance sheet?

- k. Has the entity constructed any of its property and equipment items? If so, have all components of cost been reflected in measuring these items for purposes of financial statement presentation, including, but not limited to, capitalized interest?
 - l. Has there been any significant impairment in value of property and equipment items? If so, has any impairment loss been properly reflected in the financial statements?
 - m. Are any property and equipment items mortgaged or otherwise encumbered? If so, are these mortgages and encumbrances properly reflected in the financial statements?
8. Intangibles and Other Assets
- a. What is the nature of the amounts included in other assets?
 - b. Do these assets represent costs that will benefit future periods? What is the amortization policy related to these assets? Is this policy appropriate?
 - c. Have other assets been properly classified between current and noncurrent?
 - d. Are intangible assets with finite lives being appropriately amortized?
 - e. Are the costs associated with computer software properly reflected as intangible assets (rather than property and equipment) in the financial statements?
 - f. Are the costs associated with goodwill (and other intangible assets with indefinite lives) properly reflected as intangible assets in the financial statements? Has amortization ceased related to these assets?
 - g. Has there been any significant impairment in value of these assets? If so, has any impairment loss been properly reflected in the financial statements?
 - h. Are any of these assets mortgaged or otherwise encumbered?
9. Accounts and Short-Term Notes Payable and Accrued Liabilities
- a. Have significant payables been reflected in the financial statements?
 - b. Are loans from financial institutions and other short-term liabilities properly classified in the financial statements?
 - c. Have significant accruals (for example, payroll, interest, provisions for pension and profit-sharing plans, or other postretirement benefit obligations) been properly reflected in the financial statements?
 - d. Has a liability for employees' compensation for future absences been properly accrued and disclosed in the financial statements?

e. Are any liabilities collateralized or subordinated? If so, are those liabilities disclosed in the financial statements?

f. Are there any payables to employees and related parties?

10. Long-Term Liabilities

a. Are the terms and other provisions of long-term liability agreements properly disclosed in the financial statements?

b. Have liabilities been properly classified between current and non-current?

c. Has interest expense been properly accrued and reflected in the financial statements?

d. Is the company in compliance with loan covenants and agreements? If not, is the noncompliance properly disclosed in the financial statements?

e. Are any long-term liabilities collateralized or subordinated? If so, are these facts disclosed in the financial statements?

f. Are there any obligations that, by their terms, are due on demand within one year from the balance sheet date? If so, have these obligations been properly reclassified into the current liability section of the balance sheet?

11. Income and Other Taxes

a. Do the financial statements reflect an appropriate provision for current and prior-year income taxes payable?

b. Have any assessments or reassessments been received? Are there tax authority examinations in process?

c. Are there any temporary differences between book and tax amounts? If so, have deferred taxes on these differences been properly reflected in the financial statements?

d. Do the financial statements reflect an appropriate provision for taxes other than income taxes (for example, franchise, sales)?

e. Have all required tax payments been made on a timely basis?

12. Other Liabilities, Contingencies, and Commitments

a. What is the nature of the amounts included in other liabilities?

b. Have other liabilities been properly classified between current and noncurrent?

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

13. Equity

- a. What is the nature of any changes in equity accounts during each reporting period?
- b. What classes of stock (other ownership interests) have been authorized?
- c. What is the par or stated value of the various classes of stock (other ownership interests)?
- d. Do amounts of outstanding shares of stock (other ownership interests) agree with subsidiary records?
- e. Have pertinent rights and privileges of ownership interests been properly disclosed in the financial statements?
- f. Does the entity have any mandatorily redeemable ownership interests? If so, have these ownership interests been evaluated so that a proper determination has been made related to whether these ownership interests should be measured and reclassified to the

liability section of the balance sheet? Are redemption features associated with ownership interests clearly disclosed in the financial statements?

- g. Have dividend (distribution) and liquidation preferences related to ownership interests been properly disclosed in the financial statements?
- h. Do disclosures related to ownership interests include any applicable call provisions (prices and dates), conversion provisions (prices and rates), unusual voting rights, significant terms of contracts to issue additional ownership interests, or any other unusual features associated with the ownership interests?
- i. Are syndication fees properly reflected in the financial statements as a reduction of equity (rather than an asset)?
- j. Have any stock options or other stock compensation awards been granted to employees or others? If so, are these options or awards properly measured and disclosed in the financial statements?
- k. Has the entity made any acquisitions of its own stock? If so, are the amounts associated with these reacquired shares properly reflected in the financial statements as a reduction in equity? Is the presentation in accordance with applicable state laws?
- l. Are there any restrictions or appropriations on retained earnings or other capital accounts? If so, are these restrictions or appropriations properly reflected in the financial statements?

14. Revenue and Expenses

- a. What is the entity's revenue recognition policy? Is the policy appropriate? Has the policy been consistently applied and appropriately disclosed?
- b. Are revenues from sales of products and rendering of services recognized in the appropriate reporting period (that is, when the products have been delivered and when the services have been performed)?
- c. Were any sales recorded under a "bill and hold" arrangement? If yes, have the criteria been met to record the transaction as a sale?
- d. Are purchases and expenses recognized in the appropriate reporting period (that is, matched against revenue) and properly classified in the financial statements?
- e. Do the financial statements include discontinued operations, items that might be considered extraordinary, or both? If so, are amounts associated with discontinued operations, extraordinary items, or both properly displayed in the income statement?

f. Does the entity have any gains or losses that would necessitate the display of comprehensive income (for example, gains/losses on available-for-sale securities or cash flow hedge derivatives)? If so, have these items been properly displayed within comprehensive income (rather than included in the determination of net income)?

15. Other

a. Have events occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements?

b. Have actions taken at stockholders, directors, committees of directors, or comparable meetings that affect the financial statements been reflected in the financial statements?

c. Are significant estimates and material concentrations (for example, customers or suppliers) properly disclosed in the financial statements?

d. Are there plans or intentions that may materially affect the carrying amounts or classification of assets and liabilities reflected in the financial statements?

e. Have there been any material transactions between or among related parties (for example, sales, purchases, loans, or leasing arrangements)? If so, are these transactions properly disclosed in the financial statements?

f. Are there uncertainties that could have a material impact on the financial statements? Is there any change in the status of previously disclosed material uncertainties? Are all uncertainties, including going concern matters, that could have a material impact on the financial statements properly disclosed in the financial statements?

g. Are barter or other nonmonetary transactions properly recorded and disclosed? ***Have nonmonetary asset exchanges involving commercial substance been reflected in the financial statements at fair value? Have nonmonetary asset exchanges not involving commercial substance been reflected in the financial statements at carrying value?***

[Paragraph renumbered by the issuance of Statement on Standards for Accounting and Review Services No. 9, November 2002. Paragraph subsequently renumbered and amended, effective for reviews of financial statements for periods ending on or after December 15, 2004, by Statement on Standards for Accounting and Review Services No. 10.]