
SECTION 722

INTERIM FINANCIAL INFORMATION

Authoritative Pronouncements

SAS-100—Interim Financial Information

SAS-116—Interim Financial Information

Overview

Interim financial information may be issued on a monthly or quarterly basis or at any other interval deemed appropriate by the client or a regulatory authority. SAS-100, as amended by SAS-116, notes that an interim period also includes data or information issued for a 12-month period ending on a date other than the client's normal year-end date.

IMPORTANT NOTICE FOR 2010: The Auditing Standards Board (ASB) issued SAS-116 (Interim Financial Information), which amends SAS-110 to establish standards and provide guidance on the independent accountant's professional responsibilities when he or she is engaged to review interim financial information of a nonissuer. SAS-116 removes the guidance for reviews of the interim financial statements of issuers because such guidance appropriately resides in the auditing standards of the PCAOB. SAS-116 was issued in conjunction with the issuance of SSSARS-18 (Applicability of Statements on Standards for Accounting and Review Services). Together, SAS-116 and SSARS-18 require the accountant to follow the guidance in AU 722 when engaged by a nonissuer to review interim financial information.

Interim financial information may be presented alone or included in a note to the audited financial statements. SAS-116 applies when the accountant is engaged by a nonissuer to review interim financial information if

- The entity's latest financial statements have been audited by the accountant or a predecessor;
- The accountant has been engaged to audit the current-year financial statements or audited the entity's latest annual financial statements and expects to be engaged to audit the current-year financial statements; and
- The client prepares its interim financial information in accordance with the same financial reporting framework as that used to prepare the annual financial statements.

SAS-116 also applies to reviews of interim financial information that is condensed information if all of the following conditions are met:

- The condensed interim financial information purports to conform with an appropriate financial reporting framework, which includes appropriate form and content of interim financial statements;
- The condensed interim financial information includes a note that the financial information does not represent complete financial statements and should be read in conjunction with the entity's latest annual audited financial statements; and
- The condensed financial information accompanies the entity's latest audited annual financial statements or such audited annual financial statements are made readily available by the entity.

PLANNING AID REMINDER: SAS-100, as amended by SAS-116, is applicable to interim financial information that is to be reviewed. Interim financial statements may be audited, in which case the auditor follows generally accepted auditing standards. The special accounting practices and modifications established by APB-28 (Interim Financial Reporting) and Financial Accounting Standards Board Interpretation No. 18 (FIN-18) (Accounting for Income Taxes in Interim Periods) should be followed in the preparation of the interim financial statements, with one exception: APB-28 states that the gross-profit method can be used to determine inventories at the interim date; however, if the interim financial statements are audited, the auditor would have to observe the inventory at or near the date of the interim statements.

PUBLIC COMPANY IMPLICATION: The PCAOB's AS-7 (Engagement Quality Review) establishes standards for the performance of an engagement quality review. AS-7 applies to all firms registered with the PCAOB (prior to AS-7, only firms that were members of the AICPA's SECPS were required to perform a concurring review). In addition to applying to audits performed under PCAOB standards, AS-7 also applies to reviews. However, the procedures required to be performed by the engagement quality reviewer for a review of interim financial information would be more limited. For all such engagements, an engagement review would be required to be conducted before the report is issued. The engagement reviewer would be required to be a partner of the firm performing the engagement, another person in an equivalent position in the firm, or an individual outside the firm who is associated with a registered public accounting firm. The engagement reviewer would be required to have competence, independence, integrity, and objectivity. He or she would be required to have the

level of competence needed to have an overall responsibility for the engagement under review (although the quality reviewer is not actually serving as the engagement partner). To maintain objectivity, the engagement reviewer would not be permitted to make decisions for the engagement team or assume responsibilities of the team. In addition, a partner cannot serve as the engagement quality reviewer for a client if the partner had served as the engagement partner for either of the client's two previous audits; however, this prohibition does not apply to certain small auditing firms that are exempt from the audit partner rotation rules under SEC regulation. Certain review procedures are required on every audit engagement, and review procedures generally involve discussions with engagement personnel and review of documents. Review procedures must be performed with due professional care and professional skepticism. Required engagement quality review procedures are more limited when the service being reviewed is an interim review. In addition, the engagement quality reviewer would be required to review documentation in the areas that he or she reviewed. The engagement quality reviewer would be required to assess whether this documentation indicates that the engagement team responded appropriately to significant risks (audit engagements only) and whether the documentation supports conclusions reached by the engagement team (both for audit and review engagements). The engagement quality reviewer must adequately document his or her review procedures. The firm would not be permitted to issue its report (or communicate its conclusion to the client if no report was to be issued) until the engagement quality reviewer granted his or her concurring approval. The PCAOB has stated that compliance with ASB standards (e.g., SQCS-7) is not sufficient to comply with AS-7.

Responsibility and function of the accountant

The purpose of an audit is to determine whether the financial statements are presented fairly in accordance with generally accepted accounting principles. A review of interim financial information differs significantly from an audit of financial information, because a review does not include the collection of corroborative evidence through the performance of typical substantive audit tests. Basically, the review of interim financial information consists of the performance of certain inquiries and analytical procedures. For these reasons, a review provides limited assurance on the interim financial information.

SAS-100, as amended by SAS-116, states that the purpose of a review is to provide the accountant with a basis for reporting whether material modifications are necessary for the interim financial information to be in

conformity with the applicable financial reporting framework. The accountant acquires the basis for reporting by applying the standards for a review of interim financial information in accordance with AU 722. The accountant issues a report containing an expression of limited assurance that, on the basis of the review, he or she is not aware of any material modification that should be made to the interim financial information for it to be in conformity with the applicable financial reporting framework.

Pre-engagement planning

Rule 201 of the Code of Professional Conduct states, in part, that a professional service engagement must be adequately planned and supervised. The Code defines professional services as one or more types of services performed in the practice of public accounting. Thus, Rule 201 is applicable to a review of interim financial information. In most instances, the auditor's review of interim financial information is a continuation of a professional relationship that has included the audit of the prior period's annual financial statements. For this reason, much of the pre-engagement planning is an extension of the audit engagement, which is discussed in AU 311.

Promulgated procedures checklist

The auditor should perform the following procedures when reporting on interim financial information:

- Establish an understanding with the client.
- Acquire knowledge of the entity's business and internal control.
- Perform analytical procedures and related inquiries.
- Perform inquiries and other review procedures.
- Consider making inquiries related to litigation, claims, and assessments.
- Consider making inquiries concerning the entity's ability to continue as a going concern.
- Consider performing extended interim review procedures.
- Obtain written representations from management.
- Evaluate the results of performing the review procedures.
- Consider communicating with management, audit committees, and others.
- Prepare appropriate documentation for the review engagement.

Analysis and Application of Procedures

Establish an understanding with the client

The accountant should establish an understanding with the client concerning the review of interim financial information in order that both parties clearly understand the purpose of the engagement. SAS-116 requires the accountant to document the understanding through a written communication with the client. SAS-100, as amended by SAS-116, points out that the understanding would generally encompass the following points:

- 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 the applicable financial reporting framework.
- 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 misstatements in the interim financial information and consider the likelihood of their occurrence and
 - 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 the applicable financial reporting framework.
- Limitations of a review engagement, including acknowledgement that a review does not provide a basis for expressing an opinion on the interim financial information.
- 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 in its representation letter to the accountant that the effects of any uncorrected misstatements aggregated by the accountant during the current engagement and pertaining to the current period(s) under review are immaterial, both individually and in the aggregate, to the 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. Accordingly, the accountant will not express an opinion on the interim financial information.
- A description of the expected form of the accountant's communication (whether as a written or oral report) upon completion of the engagement and a statement that if the entity states in any report, document, or written communication containing the interim financial information that the information has been reviewed by the accountant or makes other reference to the accountant's association, that the accountant's review report will be included in the document.
- A review is not designed to provide assurance on internal control or to identify control deficiencies. However, the accountant is responsible for communicating to management and those charged with governance any significant deficiencies or material weaknesses in internal control over financial reporting that come to his or her attention.

PLANNING AID REMINDER: SAS-115 (Communication of Internal Control Related Matters Identified in an Audit), requires the auditor of financial statements to communicate in writing to management and those charged with governance significant deficiencies and material weaknesses that were identified. Although an audit of financial statements is not designed to perform procedures to detect control deficiencies,

SAS-115 requires the communications when the auditor identifies significant deficiencies and material weaknesses in internal control over financial reporting. The ASB adopted the PCAOB definitions of “control deficiency,” “significant deficiency,” and “material weakness.”

PUBLIC COMPANY IMPLICATION: Although a review is not designed to provide assurance on internal control, the auditor’s involvement in evaluating internal controls on an interim basis is likely to increase because of SEC and PCAOB requirements. First, management must disclose to the auditor (1) all changes during the quarter in internal control over financial reporting that materially affected, or are likely to materially affect, the entity’s internal control, (2) all significant deficiencies and material weaknesses in the design and operation of internal control on a quarterly basis, and (3) any fraud, regardless of materiality, involving management or any other person who plays an important role in the entity’s internal control over financial reporting. Second, because the auditor must issue its own opinion on the effectiveness of the entity’s internal control over financial reporting as part of its annual audit report, it seems likely that internal control testing will occur throughout the year.

Acquire knowledge of the entity’s business and internal control

In order to successfully execute a review of interim financial information, the accountant must have both an understanding of the client’s business and its internal control used to prepare annual as well as interim financial information. This background (1) helps identify financial information that has the greatest potential for misstatement and (2) provides focus in determining which analytical procedures and inquiries should be made. SAS-100, as amended by SAS-116, states that procedures such as the following should be employed in order to acquire knowledge of the entity’s business and internal control.

Review audit documentation of the previous year’s audit, current year’s interim review(s), and corresponding interim period(s) of the prior year and specifically:

- Consider corrected material misstatements.
- Consider nature of uncorrected misstatements.
- Identify risks as related to material misstatements due to fraud (including the risk of management overriding controls).
- Identify significant accounting and reporting matters, such as internal control significant deficiencies or material weaknesses that may still exist.

- Read the most recent annual and comparable prior interim period financial information.
- Consider the results of applying audit procedures to the current year's financial statements.
- Make inquiries of management concerning changes in its business activities.
- Make inquiries of management concerning changes in internal control (such as policies, procedures, and personnel) related to interim financial information that have occurred since the previous audit of annual financial information or prior review of interim financial information.

PUBLIC COMPANY IMPLICATION: Management must disclose to the auditor all changes during the quarter in internal control over financial reporting that materially affected, or are likely to materially affect, the entity's internal control.

If the accountant has not previously reviewed a new client's interim financial information, he or she must nonetheless obtain an adequate understanding of the client's business and its internal control. Specifically, under this circumstance, the accountant should do the following:

- Make appropriate inquiries of the predecessor accountant.
- Obtain permission from the predecessor accountant in order to review his or her audit documentation for the previous annual audit and for any reviews made during the current year and consider the nature of the following:
 - Corrected material misstatements.
 - Nature of uncorrected misstatements.
 - Risks identified as related to material misstatements due to fraud (including the risk of management overriding controls).
 - Significant accounting and reporting matters, such as internal control weaknesses that may still exist.

OBSERVATION: The accountant should also consider obtaining permission from the predecessor accountant in order to review his or her audit documentation for interim reviews made during the previous year.

When the predecessor accountant does not respond to the accountant's inquiries or allow access to audit documentation for previous engagements,

the accountant must use alternative procedures in order to obtain an adequate understanding of the client's business and internal control.

Perform Analytical Procedures and Related Inquiries

Analytical procedures should be applied by the accountant in order 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.” The specific analytical procedures and related inquiries employed should be based on the accountant's understanding of the client's business and internal control discussed in the previous section. SAS-100, as amended by SAS-116, identifies the following as analytical procedures that should be performed in a review of interim financial information:

- Compare the current interim information to the previous interim information.
- Compare the current interim information to the comparable period in the previous year.
- Compare the current year-to-date interim information to the comparable period in the previous year.
- Consider reasonable relationships between financial and nonfinancial information (the information may include material developed by client).
- Compare recorded amounts (including ratios derived from recorded amounts) to expectations developed by the accountant.
- Compare disaggregated revenue information with similar information for previous periods.

Perform Inquiries and Other Review Procedures

In addition to performing the analytical procedures described above to provide a basis for making inquiries of members of management, the following review procedures should be performed:

- Read minutes of meetings of stockholders, directors, and appropriate committees (for meetings where minutes are not available, make inquiries of appropriate personnel).
- Read reports prepared by other accountants who have reviewed subsidiaries, segments, etc. of the client (for reviews in which reports were not prepared, make inquiries of the other accountants).

Based on the performance of analytical procedures, the reading of minutes of meetings, the reading of reports prepared by other accountants, and other procedures that may have been performed, the following inquiries should be made of management:

- Has the interim financial information been prepared in accordance with the applicable financial reporting framework?
- What is the nature and purpose of unusual or complex situations that affect the interim financial information?
- What is the nature and purpose of significant transactions recognized during the last few days of the interim period?
- What is the status of unrecorded misstatements identified in the previous audit engagement or the previous interim review engagement?
- What is the explanation for a matter discovered during the current review engagement?
- Are there events that have occurred after the interim period that might affect interim financial information?
- Is there fraud or suspected fraud involving (1) management, (2) employees who have significant roles in internal control, or (3) others where the fraud could have a material implication for the interim financial information?
- Are there any allegations of fraud or suspected fraud made by various external parties or regulators?
- What is the nature and purpose of significant journal entries and other adjustments?
- Have there been communications from regulatory agencies concerning the financial information?
- What is the nature of significant deficiencies and material weaknesses in internal control that could have an effect on preparing both annual and interim financial information?

In addition to the above inquiries, SAS-100 requires that the following additional procedures be performed as part of the review of interim financial information:

- Determine that the interim financial information agrees (or reconciles) with the accounting records and make inquiries of management concerning the reliability of the accounting records.