

## **Reporting on Financial Statements**

Each residential mortgage licensee is required to have its financial statements audited annually by an independent certified public accountant. For licensees who solely broker residential mortgage loans, instead of the audit, compilation financial statements may be acceptable. However, the Illinois Residential Mortgage License Act of 1987 ("RMLA") requires that a compilation report be prepared by a licensed Certified Public Accountant ("CPA"), and it must contain all disclosures required by generally accepted accounting principles. These are the same disclosures that are required for an audit.

### **Types of Reports**

There are three types of reports on financial statements, a compilation, a review, and an audit. Each is designed to meet a different need and provided a different level of assurance as to the fair presentation of the financial statements.

A compilation is useful to small, privately held entities that need help in preparing their financial statements. It entails preparing financial statements based on information provided by the entity's management.

A review may be adequate for entities that must report their financial positions to third parties, such as creditors or regulatory agencies. Reviewed financial statements may also be useful to business owners who are not actively involved in managing their companies. The submission of a review report is not contemplated by the RMLA.

Audits are appropriate for entities that must offer a higher level of assurance to outside parties. An unqualified opinion from a CPA after an audit provides reasonable assurance to outside parties that the entity's financial statements fairly present its financial position and results of operation in accordance with generally accepted accounting principles. An audit includes such procedures as confirmation with outside parties, observation of inventories, and testing selected transactions by examining supporting documents.

### **Compilation**

A compilation offers no assurance as to whether material, or significant, changes are necessary for the financial statements to be in conformity with generally accepted accounting principles. During a compilation, the data is simply arranged into a conventional financial statement format. No investigation is undertaken unless the CPA becomes aware that the information provided is in error or is incomplete.

### **What does a compilation involve?**

The CPA becomes familiar with the accounting principles and practices common to the client's industry, and acquires a general understanding of the entity's transactions and how they are recorded.

After compiling the financial statements, the CPA is obliged to read them and consider whether they are appropriate in form and free from obvious material errors. The CPA then issues a standard report that says, in effect, that the financial statements were compiled, but because they were not audited, no opinion is expressed.

Compilation standards permit an accountant to compile financial statements that omit footnote disclosures required by generally accepted accounting. This is not allowable under the RMLA. The compilation must contain all disclosures required by generally accepted accounting principles. These are the same disclosures that are required for an audit.

## **Audit**

Companies must engage a licensed CPA to audit its financial statements and to issue a report that provides the highest level of assurance that the financial statements are presented fairly in conformity with generally accepted accounting principles. In an audit the CPA must be independent of the client and the financial statements must contain all required footnotes. In Illinois, a CPA, licensed by the State must perform an audit.

### **What does an audit involve?**

To gather evidence on the reliability of the financial statements, the CPA performs verification procedures. In an audit, the CPA generally confirms balances with banks or creditors, observes inventory counting, and tests selected transactions by examining supporting documents. Sources outside the client organization are contacted to gather information that may be more objective than that obtained from internal sources. For example, the CPA usually obtains written confirmation from a client's customers about client receivables. By accumulating this type of evidence, the CPA tries to reduce the risk that the financial statements will be materially misstated.

The auditor then issues a report stating that the financial statements are presented fairly, in all material respects, in conformity with generally accepted accounting principles. An audit is planned and performed to provide reasonable assurance that material errors or fraud are detected. Fraud concealed through forgery or collusion may not be found because the auditor is not trained to catch forgeries, nor will customary audit procedures detect all conspiracies. An audit provides a reasonable level of assurance that the financial statements are free of material errors and fraud. An audit does not, however, provide a guarantee of absolute assurance.