AICPA

Practice Aid: Analytical Procedures in a Review Engagement

Accounting and Review Services Committee (2022-2023)

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This Practice Aid is an *other preparation, compilation and review publication* as defined in paragraph .07 of AR-C section 60, *General Principles for Engagements Performed in Accordance With Statements on Standards for Accounting and Review Services.* As such, this Practice Aid has no authoritative status, however, *other preparation, compilation and review publications* may help the accountant understand and apply the Statements on Standards for Accounting and Review Services (SSARSs). Pursuant to paragraph .19 of AR-C section 60, in applying the guidance included in an other preparation, compilation and review publication, the accountant should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the engagement. As this Practice Aid is published by the AICPA and has been reviewed by AICPA Audit and Attest Standards staff, an accountant may presume that it is appropriate.

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Purpose

This Practice Aid illustrates and demonstrates the importance of forming expectations and considering the precision of the expectation, two of the most misunderstood concepts when applying analytical procedures in a review engagement. These concepts are particularly important as the results of the accountant's analytical procedures provide a substantial amount of the information used by the accountant to provide a reasonable basis for obtaining limited assurance. Understanding the precision of the expectation is vital as limited assurance, while less than the reasonable assurance obtained in an audit, is a meaningful level of assurance that is significantly more than minimal.

Analytical Procedures as Review Evidence to Support the Accountant's Conclusion on the Financial Statements

In conducting a review of financial statements, the objectives of the accountant are to obtain limited assurance, primarily by performing analytical procedures and inquiries, as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework and report on the financial statements as a whole and communicate, as required by AR-C section 90, *Review of Financial Statements (AICPA,* Professional Standards*)*. An accountant cannot perform a review of financial statements without performing analytical procedures.

In accordance with paragraph .24 of AR-C section 90, based on the accountant's understanding of the industry, knowledge of the entity, and the accountant's awareness of the risks that the accountant may unknowingly issue an inappropriate accountant's review report, the accountant should design and perform analytical procedures and make inquiries and perform other procedures,[1] as appropriate, to obtain sufficient appropriate review evidence as a basis for reporting whether the accountant is aware of any material modifications that should be made to the financial statements in order for the statements to be in accordance with the applicable financial reporting framework. In obtaining sufficient appropriate review evidence as the basis for a conclusion on the financial statement as a whole, in accordance with paragraph .25 of AR-C section 90, the accountant should design and perform the analytical procedures and inquiries to address all material items in the financial statements, including disclosures, and areas in the financial statements where the accountant believes there are increased risks of material misstatements.

Concepts

Analytical procedures are defined in paragraph .08 of AR-C section 90, *Review of Financial Statements* as "evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount." The definition implies several key concepts:

- The "evaluations of financial information" suggests that analytical procedures will be used to understand or test financial statement relationships or balances.
- The "investigation…of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount" implies an understanding of what can reasonably be expected and involves a comparison of the recorded book values with an accountant's expectations and an understanding of those differences.
- "Relationships among both financial and nonfinancial data" suggests that both types of data can be useful in understanding the relationships of the financial information and, therefore in forming an expectation.

The effectiveness of analytical procedures lies in developing expectations that can reasonably be expected to identify unexpected relationships.

Expectations

Expectations are the accountant's predictions of recorded accounts or ratios. In performing analytical procedures, the accountant develops the expectation in such a way that a significant difference between it and the recorded amount is indicative of a misstatement, unless he or she can obtain explanations for the difference (for example, an unusual event occurred) that are reasonable and consistent in light of the results of other review procedures (such as the accountant's inquiry procedures and other procedures performed

[1] *Other procedures* related to analytical procedures are discussed further on pages 15-16 of this Practice Aid.

to obtain limited assurance) and the accountant's knowledge of the entity's business. Expectations are developed by identifying plausible relationships (for example, store square footage and retail sales) that are reasonably expected to exist based on the accountant's understanding of the client and of the industry in which the client operates. The accountant may select from a variety of data sources to form expectations. For example, the accountant may use prior-period information (adjusted for expected changes[2]), management's budgets or forecasts, industry data, or nonfinancial data. The source of information determines, in part, the precision with which the accountant predicts an account balance and, therefore, is important to consider in developing an expectation to achieve the limited assurance from the analytical procedure.

Precision

The effectiveness of analytical procedures depends on their precision. Precision is a measure of the closeness of the accountant's expectation to the correct amount. The level of precision of ~~E~~expectations developed by the accountant in performing analytical procedures in connection with a review of financial statements may directly impact the level of assurance obtained from the performance of those analytical procedures. ~~be (and are generally) less precise than those developed in an audit.~~Therefore, the precision of expectations is a way the accountant can address areas where they believe there are increased risks of material misstatement. Factors that affect the precision of analytical procedures include:

- the type of expectation developed.
- the reliability and other characteristics of the data used in forming the expectation (both internally and externally prepared data).
- the consistency of characteristics of the data.
- the nature of the account.

For example, an accountant plans to obtain limited assurance with respect to interest income. The accountant can obtain more assurance by developing a relatively precise expectation by selecting the appropriate type of expectation (for example, a reasonableness test instead of a simple trend analysis), the level of detail of the data (for example, quarterly versus annual data), and the reliability of the source of the data. The precision of the expectation is the primary determinant of the amount of assurance obtained from the analytical procedure. It affects the ability of the accountant to identify correctly whether a given unexpected difference in an account balance is the result of a misstatement.

Analytical Procedure Process: Four Phases

The use of analytical procedures can be considered a process that consists of four phases. The first phase is the expectation-formation process. In this phase, the accountant forms an expectation of an account balance or financial relationship. In doing so, the accountant determines the precision of the expectation and thus, in part, the effectiveness of the analytical procedure.

The remaining three phases consist of the identification, inquiry, and evaluation of the difference between the accountant's expected value and the recorded book value considering the accountant's determination of materiality. In the second phase, identification, the accountant identifies whether an unusual fluctuation exists between the expected and recorded amounts. In the third, inquiry, the accountant inquires of management regarding the cause of unexpected differences to identify a plausible explanation for each unexpected difference. Finally, in the evaluation phase, the accountant evaluates the likelihood of material misstatement and determines the nature and extent of any additional review procedures that may be considered necessary.

Phase 1 – Expectation Formation

[2] See ***Accountant's Understanding of the Entity and the Industry in Which the Entity Operates*** on page 8 for an example regarding the importance of adjusting the accountant's expectation for changes in the entity's business.

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Forming an expectation is the most important phase of the analytical procedure process. The more precise the expectation (that is, the closer the accountant's expectation is to the correct balance or relationship), the more effective the procedure will be at identifying potential misstatements. ~~Because of this, the expectation in a review engagement is typically not as precise as the any expectation formed as part of a substantive audit procedure.~~ In a review engagement the expectation only needs to be precise enough to provide limited assurance that differences that may be potential misstatements, individually or when aggregated with other misstatements, would be identified for the accountant to inquire of management regarding the cause of unexpected differences. While limited assurance is less than the reasonable (high) level of assurance obtained in an audit engagement, it is a meaningful level of assurance that is intended to provide a basis for the accountant's conclusion in the review report that users can rely on in making determinations regarding the financial statements.

The effectiveness of an analytical procedure is a function of three factors related to the precision with which the expectation is developed: (*a*) the nature of the account, (*b*) the reliability, consistency, and other characteristics of the data, and (*c*) the inherent precision of the expectation method used. Following is a discussion about each of these factors.

Accountant's Understanding of the Entity and the Industry in Which the Entity Operates

The accountant develops expectations through identifying and using relationships that are reasonably expected to exist, based on the accountant's understanding of the entity and the industry in which the entity operates. Typically, the accountant would inquire of members of management whether there have been any changes in:

a. the entity's business and
b. the accounting principles and practices used by the entity

These inquiries will assist the accountant in developing expectations. Additionally, understanding the industry in which the entity operates, including economic trends and industry indictors, will assist in developing expectations.

For example, paragraph .26*a* of AR-C section 90 requires that the accountant compare the financial statements with comparable information for the prior period, giving consideration to knowledge about changes in the entity's business and specific transactions. Assume that the entity is a restaurant, and the financial statements are for the period during the economic shutdown due to the COVIC-19 pandemic. The entity likely received government relief grants and converted its operations from dine-in to take out. The entity's economic model was completely different, and the accountant's expectations likewise would be different, had the economic shutdown not occurred. It would significantly negatively impact the effectiveness of the analytical procedure if the accountant simply compared current year financial statements with those of the prior period and explained any fluctuations to being the result of the shutdown. Instead, the accountant should compare the current year amounts to expectations based on the changed economic environment. In this way, the analytical procedure may identify a potential misstatement due to improper recording of government grants or overstatement of revenue from dine-in operations.

Nature of the Account or Assertion

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Analytical procedures are based on relationships between data, for example, how this year compares with last and how amounts on a balance sheet relate to income and expense items. The more predictable the relationships are, the more precise the expectation will be. The following are factors an accountant may consider in predicting the amount of an account:

- The subjective or objective nature of the items in an account balance (for example, whether the account comprises estimates or the accumulation of transactions)
- Consistency of items or transactions in an account balance

- Product mix
- Company profile (for example, the number of stores or the various locations)
- Management's discretion (for example, estimates)
- Stability of the environment
- Income statement or balance sheet account

Numerous factors affect the amount of an account balance. Increasing the number of such factors considered in forming an expectation of the account balance increases the precision of the expectation. Such factors include

- significant events.
- accounting changes.
- business and industry factors.
- market and economic factors.
- management incentives.
- initial versus repeat engagement.

Moreover, expectations developed for income statement accounts tend to be more precise than expectations for balance sheet accounts because income statement relationships generally are more predictable. In addition, expectations formed under stable economic conditions (for example, stable interest rates) or stable environmental factors (for example, no regulatory changes) tend to be more precise relative to an unstable economy or environment.

Reliability and Other Characteristics of the Data

In forming an expectation, an accountant considers two broad factors related to the characteristics of the data included in the account: the level of detail on which the accountant is able to base his or her expectation and the reliability of the data.

In general, the more disaggregated the data, the more precise the expectation. For example, the use of monthly instead of annual data tends to improve the precision of the expectation. Preparing an expectation by store or division is also more precise than an expectation based on consolidated data. Also, the accountant can increase precision by disaggregating data based on the characteristics of the data to achieve greater consistency.

The more reliable the source of the data, the more precise the expectation. The following are factors related to the reliability of data that the accountant may consider in forming the expectation:

- *Outside versus internal data and degree of independence.* Data from more objective or independent sources are more reliable (for example, third-party generated versus management generated).
- *Nonfinancial versus financial data.* The use of reliable nonfinancial data (for example, store square footage or occupancy rates) improve the precision of the expectation.

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When analytical procedures are used to test for both overstatement and understatement, the accountant needs to ensure that the data used to build the expectation is reliable in both directions.

Inherent Precision of the Expectation Method Used

Expectations can be developed with methods as simple as using the prior-year sales balance (adjusted for expected changes) as the expectation for current year sales or as complex as multiple regression analysis that incorporates both financial (for example, cost of goods sold) and nonfinancial data (for example, store square footage) to predict retail sales. Determining which type of expectation method is appropriate is a matter of professional judgment; however, the inherent precision of the expectation method used is a consideration in developing the expectation. The four types of expectation methods and their appropriateness are discussed in the following paragraphs.

Trend analysis. This is the analysis of changes in an account balance over time. Simple trends typically compare last year's account balance to the current balance. More sophisticated trends encompass multiple time periods.

Trend analysis is most appropriate when the account or relationship is predictable (for example, sales in a stable environment). It is less effective when the entity has experienced significant operating or accounting changes, unless the accountant takes those changes into account when performing the trend analysis. The number of years used in the trend analysis is a function of the stability of operations. The more stable the operations over time, the more predictable the relations and the more appropriate the use of multiple time periods.

Trend analysis at an aggregate level (for example, trend analysis of an entity's operating units on a consolidated basis) is relatively imprecise because a material misstatement is often small relative to the natural variation in an aggregate account balance. This suggests the need to perform trend analysis on a disaggregated level (for example, by segment, product, or location, and monthly or quarterly rather than on an annual basis).

Accountants should be aware that using only the prior-year balance without considering whether it is the most appropriate expectation can lead to a bias toward accepting the current data as fairly stated, even when they are misstated.

Ratio analysis. This is the comparison of relationships between financial statement accounts (between two periods or over time), the comparison of an account with nonfinancial data (for example, revenue per order or sales per square foot), or the comparison of relationships between firms in an industry (for example, gross profit comparisons). Ratio analysis entails a comparison of interrelations between accounts, nonfinancial information, or both. Another example of ratio analysis (which is sometimes referred to as common size analysis) is the comparison of the ratio of shipping costs or other selling expenses to sales from the prior year with the current year ratio, or the comparison of shipping costs to sales with the ratio for a comparable firm in the same industry. See the appendix, "Financial Ratios," of this Practice Aid for a listing of helpful ratios.

Ratio analysis is most appropriate when the relationship between accounts is fairly predictable and stable (for example, the relationship between sales and accounts receivable). Ratio analysis can be ~~more~~ effective ~~than trend analysis~~ because comparisons between the balance sheet and income statement can ~~often~~ reveal unusual fluctuations. However, the accountant needs to be aware that developing expectations for ratios is generally less precise and that variances should be evaluated in terms of the amount of potential misstatement, not the change in the ratio. ~~that an analysis of the individual accounts would not.~~ Comparison of ratios with industry averages (or with comparable firms in the same industry) is most useful when operating factors are comparable, however it is often difficult to identify a ratio with comparable operating factors or determine if they are comparable.

Ratio analysis at an aggregate level (that is, consolidated operating units or across product lines) is relatively imprecise because a material misstatement is often small relative to the natural variations in the

ratios. This suggests the need to perform ratio analysis on a disaggregated level (for example, by segment, product, or location).

Reasonableness testing. This is the analysis of account balances or changes in account balances within an accounting period that involves the development of an expectation based on financial data, nonfinancial data, or both. For example, an expectation for hotel revenues may be developed using the average occupancy rate, the average room rate for all rooms, or room rate by category or class of room. Also, using the number of employees hired and terminated, the timing of pay changes, and the effect of vacation and sick days, the model could predict the change in payroll expense from the previous year to the current balance within a narrow dollar range.

In contrast to both trend and ratio analyses (which implicitly assume stable relationships), reasonableness tests use information to develop an explicit prediction of the account balance or relationship of interest. Reasonableness tests rely on the accountant's knowledge of the relationships, including knowledge of the factors that affect the account balances. The accountant uses that knowledge to develop assumptions for each of the key factors (for example, industry and economic factors) to estimate the account balance. A reasonableness test for sales could be explicitly formed by considering the number of units sold, the unit price by product line, different pricing structures, and an understanding of industry trends during the period. This contrasts with an implicit trend expectation for sales based on last year's sales. The latter expectation is appropriate only if there were no other factors affecting sales during the current year, which is not the usual situation.

Regression analysis. While more commonly used in financial statement audits, regression analysis ~~This~~ is the use of statistical models to quantify the accountant's expectation in dollar terms, with measurable risk and precision levels. In many cases, the client has developed analytical procedures, internal models, or both for monitoring and evaluating its business and performance. The accountant may find these internal analytics useful for developing his or her own analytical procedures. For example, an expectation for sales may be developed based on management's sales forecast, commission expense, and changes in advertising expenditures.

Regression analysis is like reasonableness testing in that there is an explicit prediction using the accountant's knowledge of the factors that affect the account balances to develop a model of the account balance. The model is most effective when the data is disaggregated.

Relationship Between the Methods Used to Develop an Expectation and the Precision of the Expectation

Of the four types of expectation methods, trend and ratio analysis generally provide~~s~~ the least precision because ~~this~~ these expectation method~~s~~ do~~es~~ not take into consideration changes in specific factors that affect the account (for example, product mix). The imprecision is magnified in the context of a changing environment in which the assumptions underlying the prior year numbers are no longer valid. For example, the accountant is predicting sales and new products have been introduced, or economic conditions affecting sales have changed significantly. Using prior year's sales (or an average of the time series) as the implicit expectation for current sales does not provide a precise expectation because it omits relevant information about additional products and changes in the economic environment. This is not intended to suggest that trend or ratio analysis is always imprecise or that ~~it~~ they cannot be improved to be more precise. For example, changing interest rates, inflation, or price changes can be incorporated or factored into trend analysis to increase the analytical procedure's precision.

Regression analysis, in contrast, provides potentially the highest level of precision because an explicit expectation is formed in which the relevant data can be incorporated in a model to predict current year sales. Regression analysis potentially can consider all of the relevant operating data (sales volume by product), changes in operations (changes in advertising levels, changes in product lines or product mix), and changes in economic conditions. In addition, regression analysis allows the accountant to measure the precision of the expectation.

The precision of ~~ratio analysis and~~ reasonableness testing typically falls somewhere in between that of trend or ratio analysis and regression analysis. However, reasonableness tests generally provide better precision because they involve the formation of explicit expectations like regression analysis. That is, reasonableness tests can employ multiple sources of data, both financial and nonfinancial, across time. Ratio analysis is like trend analysis in that it employs an implicit expectation. That is, when using a reasonableness test, the accountant may begin with the idea of predicting the balance, whereas for ratio analysis, the expectation formation process is implicit—as the ratio is compared with budget, industry, or other relevant benchmarks.

Some aspects of the foregoing analysis can be summarized and grouped according to several factors, as follows:

- *Explicit or implicit expectation.* When using reasonableness tests or regression, the accountant is explicitly forming an expectation. This approach helps to increase the precision of the expectation. In contrast, in using trend and ratio analysis the accountant may tend to rely more upon comparison and evaluation, for example, to budget, prior year, or industry figures that may not be relevant due to changes in the entity's operations or in the economic environment affecting the entity or its specific industry.

- *Number of predictors.* Trend analysis is limited to a single predictor, that is, the prior period's or periods' data for that account. ~~Because ratio analysis employs two or more related financial or nonfinancial sources of information, thus using known relationships among the accounts, the result is a more precise expectation.~~ Reasonableness tests and regression analysis further improve the precision of the expectation by allowing potentially as many variables (financial and nonfinancial) as are relevant for forming the expectation.

- *Operating data.* Trend analysis, by relying on a single predictor, does not allow the use of potentially relevant operating data~~, as do the other three types of procedures~~.

- *External data.* Reasonableness tests and regression analysis are able to use external data (for example, general economic and industry data) directly in forming the expectation. Although external data can potentially be used in ratio analysis, its use in this manner is ~~quite~~ rare.

- *Statistical power.* Of the four expectation methods described herein, only regression analysis provides the benefits of statistical precision. The statistical model provides not only a best expectation given the data at hand, but also provides quantitative measures of the fit of the model.

~~The following table illustrates how the four expectation methods differ in terms of the five criteria in the previous list for determining the most appropriate method.~~

~~The Relationship Between Types of Analytical Procedures and Selected Precision Factors~~

~~*Type of Analytical Procedure*~~	~~*Explicit or Implicit Expectation*~~	~~*Number of Predictors*~~	~~*Can Include Operating Data*~~	~~*Can Include External Data*~~	~~*Measure of Statistical Precision*~~
~~Trend Analysis~~	~~Implicit~~	~~One~~	~~No~~	~~No~~	~~No~~
~~Ratio Analysis~~	~~Implicit~~	~~Two~~	~~Yes~~	~~Limited~~	~~No~~
~~Reasonableness Test~~	~~Explicit~~	~~Two or more~~	~~Yes~~	~~Yes~~	~~No~~
~~Regression Analysis~~	~~Explicit~~	~~Two or more~~	~~Yes~~	~~Yes~~	~~Yes~~

For the reasons noted in the preceding analysis, a common and effective method of developing expectations is to combine trend analysis and reasonableness tests by modifying prior period data for operating or accounting changes. This method increases the number of predictors and therefore the

precision of the expectation. It also allows for the use of both financial and nonfinancial information as predictors.

An example is an analytical test of payroll expense. A simple trend analysis compares current period payroll expense to prior period. However, if prior period payroll expense was modified based on changes in headcount, average pay rate changes and bonus pools the precision increases significantly. The use of disaggregation, for example by employee classes can further increase precision.

Phases 2 and 3 - Identification and Inquiry

The next two phases of the analytical procedure process consist of identification and inquiry. Identification begins by comparing the accountant's expected value with the recorded amount. Given that the accountant developed an expectation with a particular amount of difference that could be accepted without further explanation, ~~he or she~~the accountant then compares the unexpected differences with the threshold. An accountant testing for the possible misstatement of the book value of an account determines whether the difference was less than the accountant's threshold. If the difference is less than the acceptable threshold, the accountant accepts the book value without further inquiry. If the difference is greater, the next step is to inquire of management regarding the difference.

Prior to inquiring of management, the accountant considers possible explanations for the difference. The greater the precision of the expectation (that is, the closer the expectation is to the correct amount), the greater the likelihood that the difference between the expected and recorded amounts is due to misstatement rather than non-misstatement causes. The difference between an accountant's expectation and the recorded book value of an account can be due to any or all the following three causes: (*a*) the difference is due to misstatements, (*b*) the difference is due to inherent factors that affect the account (for example, the predictability of the account or account subjectivity), and (*c*) the difference is due to factors related to the reliability of data used to develop the expectation. The greater the precision of the expectation, the more likely the difference between the accountant's expectation and the recorded value will be due to misstatements (cause *a*). Conversely, the less precise the expectation, the more likely it is that a misstatement cannot be identified because the difference ~~is~~ may be due to factors related to the precision of the expectation (causes *b* and *c*).

If the accountant believes that the difference is more likely due to factors related to the precision of the expectation, the accountant may consider whether a more precise expectation can be cost-effectively developed. If so, the analytical procedure can be reperformed based on the new expectation, and the new difference calculated. On the other hand, the accountant may rule out causes *b* and *c* as explanations for the unexpected difference and may then evaluate the unexpected difference as a potential misstatement. The accountant should then inquire of management to evaluate the most likely causes and identify a plausible explanation.

Plausible explanations usually relate to unusual transactions or events or accounting or business changes. In evaluating whether an explanation is plausible, the accountant might consider such factors as

- management and board reports containing explanations of significant variances between budgeted and actual results.
- review of board minutes.
- information on unusual events occurring in prior years (this may indicate the types of unusual events that could have affected the current year data).

Paragraph .28 of AR-C section 90 requires that the accountant investigate differences by inquiring of management. However, especially in areas in which the accountant is aware that the risk of material misstatement is higher, the accountant may consider inquiring of others within the entity to corroborate management's responses. For example, a construction entity may recognize revenue over time. The

accountant may determine to corroborate management's responses to the accountant's inquiries through discussion with project managers. The secondary inquiries will provide the accountant with a greater understanding of the entity's operations and may identify corroborating or conflicting review evidence. If the responses to the secondary inquiries conflict with management's initial responses, the accountant may consider additional review procedures in order to obtain limited assurance.

Phase 4 - Evaluation (Phase IV)

The final phase of the analytical procedure process consists of considering the difference between the accountant's expected value and the recorded amount. It is usually not practicable to identify factors that explain the exact amount of a difference identified for inquiry. However, the accountant attempts to quantify that portion of the difference for which plausible explanations can be obtained and determines that the amount that cannot be explained is sufficiently small to enable him or her to conclude on the absence of material misstatement.

If a reasonable explanation cannot be obtained, the accountant should, in accordance with paragraph .65 of AR-C section 90, consider the impact of uncorrected misstatements identified during the review. In performing this consideration, the accountant may consider (*a*) the size and nature of the misstatements, both in relation to particular classes of transactions, account balances, or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence and (*b*) the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances, or disclosures and the financial statements as a whole.

Other Procedures

Unlike in an audit of financial statements, in a review engagement the accountant is not required to corroborate management's responses to the accountant's inquiries. In other words, in a review engagement, the accountant is able to accept management's responses to the accountant's inquiries as sufficient appropriate review evidence without obtaining support for those responses. However, pursuant to paragraph .30 of AR-C section 90, the accountant should consider the reasonableness and consistency of management's responses in light of the results of other review procedures and the accountant's knowledge of the entity's business. If management's responses to the accountant's inquiries are not reasonable or are inconsistent with the results of other review procedures and the accountant's knowledge of the entity's business, in accordance with paragraph .28*b* of AR-C section 90, the accountant should perform other review procedures. Such other review procedures may be similar to those that would be performed in an audit of financial statements but less in extent.

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Documentation

Pursuant to paragraph .137 of AR-C section 90, the accountant should prepare review documentation in a timely manner that is sufficient to enable an experienced accountant, having no previous connection to the review, to understand the following:

a. The nature, timing, and extent of the review procedures performed to comply with SSARSs

b. The review evidence obtained from the review procedures performed and the accountant's conclusions formed on the basis of that review evidence

c. Significant matters arising during the review, the accountant's conclusions reached thereon, and significant professional judgments made in reaching those conclusions

With respect to the performance of analytical procedures, it is expected that the accountant will, at a minimum document:

a. The expectation referred to in paragraph .~~27a~~ 27c of AR-C section 90 and the factors considered in its development when that expectation and those factors are not otherwise readily determinable from the audit documentation

b. Results of the comparison referred to in paragraph .26c of AR-C section 90 of the recorded amounts, or ratios developed from recorded amounts, with the expectations

c. Any inquiries of management and other review procedures performed in accordance with paragraph .28 of AR-C section 90 relating to the investigation of fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount and the results of such procedures. The documentation of inquiries of management are expected to include management's responses to the accountant's inquiries and the accountant's determination as to whether management's responses appear reasonable.

Appendix

Financial Ratios

In the following table are several financial ratios that may be helpful while performing some of the analytical procedures contained in this Practice Aid. These financial ratios include liquidity, activity, and efficiency ratios.

Financial Ratios	***Formula***	***Explanation***
Current Ratio	Current Assets / Current Liabilities	Measures ability tomeet short term obligations
Quick Ratio (or AcidTest Ratio)	Current Assets—Inventory / Current Liabilities	A more conservative measure of an entity's ability to meet short term obligations
Operating Cash Flows to Current Liabilities	Cash Provided by Operations / Average Current Liabilities	Liquidity calculation
Days Sales in Accounts Receivable	Net Accounts Receivable / Net Sales/360	Measures length of time average sales isa receivable
Allowance for Bad Credit as a % of Accounts Receivable	Allowance for Bad Debt / Accounts Receivable	Calculation is compared to prior periods and other comparable entities
Bad Debt Expense asa % of Net Sales	Bad Debt Expense / Net Sales	Calculation is compared to prior periods and other comparable entities
Inventory Turnover	Cost of Sales / Inventory	Activity ratio—indication of efficiency of operation
Fixed Asset Turnover	Net sales / Average Fixed Assets	Activity ratio
Receivable Turnover	Net Credit Sales / Average Receivables	Activity ratio

Financial Ratios	***Formula***	***Explanation***
Net Sales to Inventory	Net sales / Inventory	Activity ratio
Days in Inventory	Inventory × (Days in a Cycle) / Cost of Sales	Identifies how many days of inventory is available
Accounts Payable toNet Sales	Accounts Payable × (Days ina cycle) / Net Sales × (Days in a year)	Compares A/P balance to net sales
Return on TotalAssets	Earnings Before Income Tax(EBIT) / Total Net Assets	Identifies effectiveuse of assets to generate earnings
Return on Net Worth	Net Income × (Days in a year) / Net Worth × (Days in a cycle)	Profitability measure
Return on Net Sales	Net Income / Net Sales	Profit margin
Net Sales to Accounts Receivable	Net Sales × (Days in a year) / Net Accounts Receivable × (Days in a cycle)	Identifies how many times Accounts Receivable will turn over per year of the operating cycle
Net Sales to NetFixed Assets	Net Sales × (Days in a year) / Fixed Assets × (Days in a cycle)	Identifies efficiency of capital investment
Income Before Tax toNet Worth	Earnings Before Income Tax(EBIT) × (Days in a year) / Net Worth × (Days in a cycle)	Ratio of earnings tonet worth per year
Gross Profit Percentage	Net Sales − Cost of Sales / Net Sales	Profitability calculation
Operating Expensesas a% of Net Sales	Operating Expenses / Net Sales	Efficiency calculation