**SHINING LIGHT FOUNDATION**
**FINANCIAL REVIEW POLICY**

## General Financial Review

- Obtain these financial data for the last three years: balance sheets; statements of income and retained earnings; statements of cash flows.
- Review the financial statements and notes, noting the type of audit report and whether there are any unusual or significant footnote disclosures.
- Describe the accounting principles employed by the company and the methods of applying those principles. Consider whether they are consistent with other companies within the industry. Your description should generally be more detailed than the information contained in the footnotes to financial statements. It should highlight differences in accounting principles employed by the buyer and seller, particularly where accounting determinations may have an effect on the transaction price.
- Determine whether there have been any changes in the application of accounting principles or methods that could make comparisons of historical financial statements more difficult. Highlight the effects on financial trends during the most recent three years caused by changes in accounting principles or methods.
- If the company has engaged a public accounting firm, arrange to review its work papers, paying particular attention to memoranda on accounting issues and legal matters and evaluations of internal accounting controls.
- Review the reports of outside specialists (e.g., actuaries, financial consultants, etc.) used by the company for their potential effect on financial matters.
- In connection with your review of the company, you should gain an understanding of the significant elements of the company's system of internal accounting controls. You should identify the key controls by discussion, inquiry and observation.

## Cash Review

- Obtain summary of banking relationships and a schedule of monthly bank balances during the year. Note trends during the year. Describe the company's policy regarding the investment of idle balances.
- Review bank account reconciliations and obtain explanations for unusual

reconciling items or reconciling items that have not been resolved on a current basis.

- Describe the company's banking arrangements. In particular, review any restrictions on cash balances, compensating balance agreements, and line of credit arrangements. Do banking arrangements appear adequate based on the company's cash requirements?
- Inquire whether there were any unusual receipts, such as settling insurance claims or other recoveries. Review the company's cash management system (forecasting, budgeting, etc.) and the attendant controls.

Marketable securities. Obtain a schedule of marketable securities, separated into current and noncurrent categories, and list original cost, date purchased, interest rate, maturity date, current basis of recording, and current market value.

## Accounts Receivable Review

- Obtain a reconciliation of the detailed accounts receivable records to general ledger control accounts and obtain explanations of unusual reconciling items.
- Describe the company's credit system. Indicate current credit policies and normal special trade terms (particularly deferred payment terms or agreements to accept returns of goods). Note changes during the past three years in standard credit terms. Compare with customary credit terms in the industry.
- Obtain an accounts receivable aging as of the most recent date possible and for the same date in the prior year. Also obtain a schedule of significant individual account balances. Discuss with management any large or overdue accounts.
- Obtain a summary of all accounts in dispute or in process of legal collection.
- Review the adequacy of the allowance for doubtful accounts, giving consideration to the current accounts receivable aging, the actual write-off experience during the past three years, and receivables collected subsequent to the balance sheet date. Inquire as to the methods used by the company to establish the allowance for doubtful accounts.
- Obtain a schedule of the number of days sales in accounts receivable for each month-end during the past three years. If the company does not use the last in, first out (LIFO) basis to calculate days sales outstanding (DSO), consider the appropriateness of the methodology

used in light of the sales cycle.

- Inquire as to unusual increases or decreases in the accounts receivable balances during the periods under review.
- Obtain a summary of accounts factored or hypothecated, the attendant costs, and whether the accounts were sold with or without recourse.
- Inquire as to company's policy for obtaining proper sales cutoffs.

If the company charges interest on past due accounts, inquire as to compliance with the Truth-In-Lending Act.

## Long-Term Investments Review

- Obtain a schedule of long-term investments showing the name, percentage of ownership, original cost, basis at which stated, and current market value.
- Determine that the method of valuation (equity versus cost) is proper as well as the method of recording income thereon.
- Obtain a schedule of all advances to affiliates or unconsolidated subsidiaries. Review the underlying financial, tax, and/or operating factors that gave rise to the balances that exist.
- Determine whether the tax basis of investments is substantially different from the book basis.

Obtain a schedule of dividend and interest income related to investments.

## Income Statement Accounts Review

- Obtain explanations for significant fluctuations in the income statements for the last three years. Captions such as cost of goods sold and selling and general and administrative expenses should be supported by detailed analysis.
- Identify nonrecurring, extraordinary, or unusual items included in profit and loss.
- Obtain an analysis of product or product line profitability (i.e., sales, cost of sales and direct selling, general and administrative expenses). Analyze gross profit percentages. Compare sales trends of product lines.
- Schedule sales to the company's largest customers, affiliated companies, and other related parties for the last three years. For affiliates and other related parties, inquire whether sales were made at arm's-length prices. For individual customers who represent a significant volume of sales, evaluate their current financial status.
- Also, for individually significant customers, coordinate with those

Thomson individuals reviewing marketing to identify how these customers are treated/handled differently, if at all, and what the current status of the company's relationship with these customers is.

- Review major long-term contracts (including government contracts; determine the method of income recognition). Inquire as to methods used by the company to monitor the status of long term contracts and whether work in process will be completed at a normal profit margin.
- Identify the company's policy with regard to sales returns and allowances and what the applicable accounting policies are. Schedule sales returns and allowances by product line (or major product) and customer. If significant returns and allowances are noted for a particular product line, identify the underlying reason. Consider the implication on matters such as the timing of the recognition of sales, adequacy of reserves, company's quality control and research and development efforts, and so on.
- Obtain an analysis and understanding of key financial and operating statistics for the last three years and projected three-year period. In addition to classic accounting and investment ratios, examine those statistics that are fundamental to business's economics, for example: (1) Market growth/share renewal rates, (2) Price, (3) Real versus inflationary growth, (4) Shifts in product mix and profitability, (5) Revenue per customer, (6) Revenue per sales representative, (7) Sales and marketing as a percentage of sales, (8) Other functional costs as a percentage of sales lead time required to ramp-up to the next level of sales activity, (9) Fixed versus variable costs (from an economic perspective), (10) Average compensation, (11) Headcount distribution, (12) Operating income per employee.
- Analyze "other income and expense" accounts. Identify separately recurring and nonrecurring items.
- Estimate increases or decreases in major income or expense categories post transaction. Consider, for example, the effect of including the acquired company's employees under the acquiring company's profit-sharing and pension plans; operating efficiencies due to the combination of similar departments or sale of duplicate facilities; and so on.

## Budgeted And Forecasted Data Review

- Obtain a description of the company's budgeting system, and discuss sources of budget input data and budgeting system controls. It is important to determine whether budget is a bottom up budget created by operating units or a top-down budget produced by senior management.

- Review prior years' budgets and compare budgeted to actual results.
- Discuss with management the basis of key assumptions, particularly where assumptions differ from recent trends.
- Identify the company's business cycle and sensitivity to general economic trends.

## Financial Information System Review

- Identify, flowchart, and describe all systems: (1) Transaction sales support and customer information, (2) Order entry and fulfillment, (3) Product development and delivery, (4) Work flow and other infrastructure, (5) Communications.
- Evaluate the adequacy of the system of controls (e.g., segregation of duties, input, processing, access and documentation controls, physical security, and system development and modification procedures). Provide headcount by function.
- Indicate whether such systems are company managed or service bureau based.
- Identify disaster recovery/contingency plans in place for key systems.
- Describe any system limitations affecting the current business, including those impacting new product development activities and the company's ability to offer all media formats.
- Detail ongoing support requirements and operational costs. Describe current ongoing development efforts and their status. Also describe any development projects planned for the next three years.

## FINANCIAL REVIEW STATEMENT

procedures that would be reasonable to conduct for a review include:

- Conduct a ratio analysis with historical, forecasted, and industry results
- Investigate findings that appear to be inconsistent
- Inquire about the procedures for recording accounting transactions
- Investigate unusual or complex situations that may impact reported results

- Investigate significant transactions occurring near the end of the accounting period
- Follow up on questions that arose during previous reviews
- Inquire about material events that occurred after the date of the financial statements
- Investigate significant journal entries
- Review communications from regulatory agencies
- Read the financial statements to see if they appear to conform with the applicable financial reporting framework
- Review the management reports of any accountants who reviewed or audited the entity's financial statements in prior periods

There are also a number of review steps that can be utilized in specific areas, such as:

- *Cash*. Are cash accounts being reconciled? Have checks written but not mailed been classified as liabilities? Is there a reconciliation of intercompany transfers?
- *Receivables*. Is there an adequate allowance for doubtful accounts? Are any receivables pledged, discounted, or factored? Are there any non-current receivables?
- *Inventory*. Are physical inventory counts performed? Were consigned goods considered during the inventory count? What cost elements are included in the cost of inventory?
- *Investments*. How are fair values determined for investments? How are gains and losses recorded following the disposal of an investment? How do you calculate investment income?
- *Fixed assets*. How are gains and losses on the disposal of fixed assets recorded? What are criteria for capitalizing expenditures? What depreciation methods are used?
- *Intangible assets*. What types of assets are recorded as intangible assets? Is amortization being appropriately applied? Have impairment losses been recognized?
- *Notes payable and accrued expenses*. Are there sufficient expense accruals? Are loans properly classified?
- *Long-term liabilities*. Are the terms of debt agreements properly disclosed? Is the entity in compliance with any loan covenants? Are loans properly classified as short-term or long-term?
- *Contingencies and commitments*. Are there guarantees to which the entity has committed itself? Are there any material contractual obligations? Are there liabilities for environmental remediation?
- *Equity*. What classes of stock have been authorized? What is the par value of each class of stock? Have stock options been properly measured and disclosed in the financial statements?
- *Revenue and expenses*. What is the revenue recognition policy? Are expenses recorded in the correct reporting period? Have the

results of discontinued operations been properly reported in the financial statements?