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CPE NETWORK

ACCOUNTING & AUDITING REPORT

FEBRUARY 2024

VOLUME 37, ISSUE 2

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- FASB Update on Business Combinations
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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Not For Profit Financial Reporting.....3

Kurt Oestrieher, CPA, reviews the guidance and issues in preparing and reporting for not for profit organizations. *[Running time: 35:54]*

Learning Objectives: Upon completion of this segment, the user should be able to:

- Identify the members of the Financial Accounting Foundation
- Determine what identifies an organization as a nonprofit
- Identify a nonprofit organization's financial statements
- Identify why a statement of functional expenses is important to donors
- Identify how endowments are classified

PART 2. AUDITING

Implementing Quality Management Standards.....21

Jennifer Louis, CPA considers issues that may arise in implementing the quality management (QM) standards CPA firms now need to comply with in maintaining their practices. *[Running time: 29:37]*

Learning Objectives: Upon completion of this segment, the user should be able to:

- Identify the purpose of updating the quality management standards
- Define quality risks
- Identify what actions help a firm manage quality risks
- Identify the relationship between complying with the new QM standards compared to the QC standards

- Identify the documentation detail needed under the new QM standards

PART 3. SMALL BUSINESS

Ethics Conceptual Framework.....39

Kurt Oestrieher, CPA, reviews the ethical conceptual framework. *[Running time: 31:42]*

Learning Objectives: Upon completion of this segment, the user should be able to:

- Determine the difference between factual independence and independence in appearance
- Identify the authoritative literature for accountants related to ethics
- Determine where the ethical guidance for conflicts of interest is found
- Identify safeguards that are most effective at reducing threats to an acceptable level
- Determine the purpose of PEEC's conceptual framework to accountants

ABOUT THE SPEAKERS

Jennifer Louis, CPA, is a CPA and president of Emergent Solutions Group, LLC. She has more than 25 years experience in designing and instructing high-quality training programs. Ms. Louis was previously executive vice president and director of training services at AuditWatch Inc., a premier training and consulting firm serving the auditing profession. She also served as financial/operational audit manager for the AARP, and as an audit manager for Deloitte.

Kurt Oestrieher, CPA, is a CPA and partner with the accounting firm of Oestrieher and Company in Alexandria, Louisiana. He is in charge of accounting and auditing services, and is also involved in litigation support and small business consulting engagements. In addition to his client responsibilities, Kurt has served as a discussion leader for numerous accounting and auditing courses. He has served on the AICPA Accounting and Review Services Committee and is currently serving a three-year term on the AICPA Council.

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PART 1. ACCOUNTING

Not for Profit Financial Reporting

The FASB sets accounting standards for both not for profit and for-profit entities. Not for profits have slightly different financial statements and transactions due to the nature of the transactions and the entity objectives. The most recent guidance for not for profit financial statements was issued in 2016 in ASU 2016-14. Among other things that guidance revised the net classification scheme to two from three; updated the accounting and disclosures on underwater endowments, and required the presentation of expenses by both nature and function.

For more on not-for-profit reporting, let's join Kurt Oestrieher, a CPA and a partner with Oestrieher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk a little bit about the history of not-for-profit financial reporting, and financial reporting, in general, for not-for-profits. To begin with, why don't you give us a little background?

Mr. Oestrieher

Yes, not-for-profits have always been interesting. I guess I'm going way, way back and remembering my college years where everyone kind of combined not-for-profit and governmental as in the same class. We thought of not-for-profits and governmental as kind of the same animal. Looking back now, I specifically remember when my professor was trying to tell us about GAAP. He said, "Well, it's something the FASB really doesn't deal with, but there's this AICPA Industry Guide out there." I think it was even *Colleges, Universities, Hospitals, and Other Nonprofits*, if I remember correctly, that was kind of the name. So, it was out there in its own world.

This either could have been the best-case scenario or worst-case scenario, and I'm still undecided, but the FAF—remember people think the FASB are their own bosses; they're not, they report to the Financial Accounting Foundation. And in the Financial Accounting Foundation you have the FASB, the GASB, and the FASAB (many people don't know about the FASAB). I guess the FAF could have said, "Well, really, we use FASB for for-profit companies, and GASB for governmental," so could they have come up with "NASB" for a not-for-profit accounting standards board? Because what everyone does seem to agree on is that the reporting for a nonprofit is different. In other words, the objectives of the company are different, ostensibly, for a for-profit versus nonprofit—we'll get into that a little bit later—so therefore, are the needs of the users of the financial statements different? And that is something everyone agreed upon, Debi. So, now we say there need to be differences.

Look at the two extremes for governmental, look how we use the modified accrual in governmental versus what we would call the normal accrual for U.S. GAAP. While there are some things that are similar between governmental and for-profit accounting, certainly the presentation, the whole fund concept, and the required supplementary information, [the differences] just continue to grow and grow. And because the differences are so extreme, that's why the FAF came up with the GASB. But ultimately, the FASB, I guess with the blessing of the FAF, said basically, "AICPA, we really appreciate you writing this guide that we use, but we are recognized. We know that there's no legal authority in the nonprofit world, there's no authoritative [guide for] nonprofits. We're going to take this ball. Hold my beer." (That might have been the first time anyone said *hold my beer*.) "We're going to do this," and they issued FASB 117, I believe about 30 years ago, and it redefined the presentation. That's when we came up with the statement of activities. It has since changed, but remember, we used to have unrestricted assets, temporarily restricted assets, and permanently restricted assets. That changed about five or six years ago. But that was the first kind of full leap where the FASB said, "No, we got this."

Their first standard was a presentation standard (what I just described), telling us what financial statements need to be there and what these need to look like. Then, basically, they said that everything else—we didn't have the Codification back then—but everything else within the GAAP hierarchy is going to apply to nonprofits. "You're going to measure revenues the same way unless we say otherwise. You're going to measure leases the same way unless we say otherwise. Everything is going to be the same unless we make it different."

This is where the Code really came to help us, because now we can go into industry-based stuff, and in Section 958, that's where you can find all the differences. Before we were codified you had to know [which] FASB standards were authoritative, and you had some FASB standards that didn't specifically address issues, so you still went back to the AICPA guide. I am convinced that that is why there is still, to this day, a little bit of confusion about exactly where is the authoritative GAAP for nonprofits? This is where people use third-party practice aids from multiple vendors for examples of financial reporting. They're not going to the Code which actually has a sample statement of financial position and statement of activity.

So, what we're going to do here is kind of help to clarify this area that has been, I guess, the most misunderstood. I don't know if it's politically incorrect to call it the "redheaded stepchild" of financial reporting because I'm married to a redhead, so she might get mad at me for saying that. But it is truly an area that is [misunderstood]. When I talk to peer reviewers, they say, "People kind of give us a hybrid, governmental-type-looking [report] sometimes" because of the purpose of nonprofits. So, that's what we want to talk about today. And when you understand the history, now you understand why it's a little bit more convoluted.

Ms. Grove Casey

Well, and it's not just the history, because a lot of nonprofits *do* receive governmental aid, so it does make it confusing. A lot of times they have volunteers, not paid CPAs, who are doing their everyday stuff. So, we have a lot of confusion there, you're right. Let's talk about the purpose of not-for-profits, because that's the reason they end up getting those governmental funds.

Mr. Oestricher

Correct, or other funds in the wide range of nonprofits. So, on one end of the spectrum, you'd have what I call "NGOs" which are nonprofit governmental organizations. Here in my hometown of Alexandria, Louisiana, rather than have the city own the zoo, the city got people who were interested in having a zoo many, many, many years ago, set up [to be] the "push," the impetus, behind forming a nonprofit and getting the community rallied around a nonprofit to create the zoo. But they also know that the admission cost isn't going to fully support it, so every year, our city gives a nice little grant to the zoo. So, those are the NGOs where—and trust me—the government that provides most of the money typically has a mechanism where they control a lot of the board seats because remember, that's what controls a nonprofit, is the board. So, on one end of the spectrum, you have the NGO.

On the other end of the spectrum, you have companies that are not-for-profit [but really operate like businesses]. Remember, the way you become a not-for-profit is you form a corporation or some other type of an entity, then you beg the IRS to not make you pay taxes on the money left over at the end of the year. After you take your revenues and you deduct expenses, if there's money left over, you say, "Please, Mr. and Mrs. IRS, don't take this money because we're good people. We're a zoo, we're educational, we are religious, we are charitable, we are this, or we are that." So, that's what a not-for-profit is. The IRS actually grants you that as part of your mission, but until the government (the IRS) says you're a nonprofit, you're really not a nonprofit. And it shocks a lot of people to find out that the PGA Tour is a nonprofit organization. Until recently, the National Football League home office was a nonprofit organization. And other fraternal-type things, like the Mardi Gras krewes here in Alexandria, which serves to have some really, really nice parties for some really wealthy people every year, are nonprofits because "We just want to raise our money, have our parade, go have a big party, and then, we just want to keep all of our money for the next year in order to not pay some of that to the government."

So, there are different purposes for not-for-profits. And when you look at the financial reporting, and at what the FASB eventually said, we're going to have to make the assumption that these not-for-profits are all there for altruistic purposes, and that any excess of receipts over disbursements are being held for this specific charitable, educational,

or whatever purpose there is. That is why you have some nonprofits that are on the end of the spectrum that really operate like businesses, like the PGA Tour that is there to try to generate large purses. Their strategy was brilliant. Years ago, Deane Beman, in the '70s, said, "Wow, we have to pay taxes on anything we have left over at the end of the year," and they started saying, "Well, all of our golf tournaments are going to be related to a charitable cause and need local sponsors." It's a win-win, because you go to any community where there's a PGA Tour event and they love the tour event because so much money goes to charity. They have raised over a billion dollars for charity, so it was truly a win-win. The only people that lost was the United States Treasury. I can't make a political comment, but some people believe the government spends our money very well. Other people, not so much.

Getting back to the FASB, it's like, "Okay, what are we going to do?" So, the FASB, you can see when we go through the required statements, they are treating this as what I would call the "altruistic not-for-profit," or the not-for-profit that is there for either a public purpose, such as a zoo or a charitable organization (like Hope House and Manna House that we have here in central Louisiana that help people who really need help). Another is religious—and there are some people who don't practice religion and they [believe religious organizations] really shouldn't get the exemption, but the Code grants that. So, there are some things that aren't exactly a public purpose, and there are other types but, ultimately, they are all about, "We're going to have money."

The distinguishing factor that we're going to see is, it's important to know where those sources of revenues are coming from, whether they're monetary or not monetary (because sometimes people contribute non-monetary assets), and if we receive donations, are there restrictions or covenants or endowments? We're going to see that in how the financial statements are organized and the footnotes. Or are the funds available to spend at the board's discretion? That was the framework, if you will, that the FASB has determined is the most appropriate and meaningful information that would be provided in nonprofit statements.

Ms. Grove Casey

Let's talk a little bit about the required financial statements because you mentioned those.

Mr. Oestrieher

Go to [Topic] 958. Anyone that works with nonprofits, go to the Codification. Go to **www.fasb.org**. I'm old school; the younger generation just Googles "FASB" and gets to the Code that way. But under Topic 958, it tells you have a statement of financial position, that's the equivalent of the balance sheet if you want to compare to the for-profit world; the statement of activities, which is the equivalent of the income statement; and then, the statement of cash flows, which is going to be exactly equivalent—but obviously, different terminology is going to be used.

In the statement of activities, you don't have net income, you have just the increase or decrease component. And you don't really have a statement of changes in members' equity because you don't have distributions or capital contributions. In other words, the only thing that changes is what we would call net assets, which is the equivalent of equity in a for-profit. It is retained—I'll use the word profits—retained untaxed profits. Is that a good way to say it? But you don't distribute to the owners because there is no distribution.

Now, one of the very important—and I include it as a financial statement, but it can be in the notes or another way, and we'll get to presentation [later], is the statement of functional expenses. That is where we see something that is truly unique, if you will, in the nonprofit world and we'll talk more in detail about that later on. Right now, I'm just going over the basic statements that you will see.

Then, of course, you have footnote disclosures like you do with any entity, and there is wording very similar to what we see in the for-profit world: comparative financial statements are not required, but they're encouraged. An interesting thing, Debi, when you look at a statement of activities and you have *with donor restrictions* or *without donor restrictions*, to do a comparative of that gets pretty unwieldy. So, usually, what we see in nonprofits, because they're not truly supposed to—I shouldn't say "supposed to" be operating in a business; they typically don't—usually the budget comparison, which is going to be in supplementary information, to me, is more meaningful than maybe comparative financial statements, just because you never know [from year to year]. Now, a nonprofit that does the same thing year after year after year, like a zoo, that's where comparatives might be a little bit more appropriate.

Ms. Grove Casey

Let's talk a little bit more about that statement of financial position.

Mr. Oestrieher

When you look at that (again, that's the equivalent of the balance sheet), one of the first things you'll notice is it's not classified. You don't have the current assets and current liabilities. That is a huge, common mistake that peer reviewers note often, because we just carry that knowledge over and think you're supposed to be classified. Instead, you have a lot of latitude in how you classify this. Typically, it's in order of liquidity, and that is the manner in which you will list both the assets of an entity and the liabilities of an entity.

Then, the more important part, what we would normally consider the equity section, the assets less the liability, that's your net assets. It is now presented (it has been for a few years now; I don't know exactly how many, but I'm pretty sure more than five) as *net assets with donor restrictions* and *net assets without donor restrictions*. The key is the donor restrictions. Many nonprofit boards will say, "Oh, look, we got this nice gift. We can do anything we want to with it." (I'm going to use the example of the zoo.) "We know that this donor who left us this in the will really, really loved monkeys and the primate area of the zoo, so we're going to build a special [exhibit]. We're going to dedicate that money to building and maintaining a great new primate exhibit." Well, that's a board designation. That's not a donor restriction. So, board designations would still be without donor restrictions, but we're going to take the footnotes and that's where we're going to describe any board [designations]. So, it has to be a donor restriction to be classified as a donor restriction. Board restrictions are considered without donor restriction net assets.

Oh, and by the way, your assets should equal your liabilities plus net assets. That's the one thing, whether you're talking about governmental, nonprofit, or anything. Please make sure—we don't call it a balance sheet, but it should balance.

Ms. Grove Casey

Now, let's talk a little bit about the statement of activities because that looks a little bit different.

Mr. Oestrieher

Yes, and we call it the statement of activities, we don't call it an income statement because, again, not-for-profits aren't supposed to be making income. We're supposed to be okay if one year we spend some of our reserves, just as long as we're accomplishing our mission. I'm sure many of the people listening in on this have served on boards of nonprofits and if you're a CPA, unfortunately, that means you think like me and whenever we are making decisions, I always ask, "What's our mission statement? What's our mission?" Our mission is not to hoard money. Our mission is to accomplish it, so it's okay if we spend extra money. So, for our activities, the focus isn't on *did we bring in more money than we spent*, but on *did we accomplish our mission*. That's how it is going to be organized.

Now, that being said, I've served on private school boards and yes, it's very important that each year our tuition and contributions cover our costs, so we still have some of those for-profit concepts, if you will. And that's what I was talking to you about earlier, that hybrid where the FASB did not give us an option to say, "Hey, we know you're operating a school, but we're going to look at this more like a business." (Because I've been in those school board meetings where they say, "This is just a business, Kurt.") Where are our revenue sources? Where are our expenses? Where's our depreciation? It's going to be in the statement of activities, with and without donor restrictions.

Then, you have revenues and gains. Now, revenues is the tricky one. That is when [Topic] 606 came out. We have to understand that contributions are not going to meet the definition of revenue recognition in 606, because there are no performance obligations. Say I'm a not-for-profit, and someone just said, "Kurt, here's \$10,000. Do something well with that." And you might've seen these articles, people said well, the person got a good feeling about it—a nice, warm, fuzzy feeling—so that's what they got. No. So, this is where the FASB has said, "No, no. We're still going to go back and look at 958, existing GAAP, on when you get to recognize a contribution." And it's more like when you have the right to that, when they have given you the right. If someone leaves you \$1 million in their will but they

haven't passed away, no, you don't get to recognize that as revenue. You actually don't even get to recognize it after they die. You have to wait until the judge hits the gavel and says, "Yes, we are transferring this. We see you as a legatee in this probate hearing."

So, those are your revenues. But if you are doing some for-profit-type stuff, running a bingo or something like that, which schools will do and other nonprofits will do, then you look at 606. So, you could either be using 606 or 958, depending on whether or not it's a contribution or not a contribution. So, that's one of the key differences that we see.

And, of course, then we still have the concept of gains. You might sell donated property that has appreciated, and there are other gains that are not either direct contributions or revenues under 606 for services provided.

Then, your next section is going to be expenses and losses, and we don't use the term *expenditure*, that's a governmental term. That's another thing that I've seen, Debi, is people bleed in these governmental terms in not-for-profits, but it's *expenses*. Depreciation will be an expense that you record. Unlike in the governmental realm where you have the fund financial statements and the government-wide, no, it's just one presentation and you record depreciation for a nonprofit organization. So, you have these expenses and losses, then, you have your change in net assets.

There's actually a project right now with the FASB on coming up with minimal amounts of disaggregation on the statement of activities (or income statement for for-profits; they're looking at globally). Right now, what the standards basically tell us is that you can aggregate these expenses or revenues or gains and losses in reasonably homogenous groups. Now, the statement of functional expenses is going to take care of the details, so we will see generally very broad categories on the statement of activities. Then, we look to the statement of functional expenses for more detail. That is what we typically see, but there's no problem whatsoever of disaggregating that information on the face of the statement of activities. If you're a small not-for-profit, that will often satisfy the requirements of the statement of functional expenses. In other words, you can show your functional expenses on the face of the statement of activities. So, like a small soccer group or something like that, that's where you see it. But for the more complex, community-wide not-for-profits, you generally will not see that.

The weird thing to make this whole thing work—and by the way, there's always a column of *with donor restrictions* and *without donor restrictions*. So, any revenues and gains that come in that have donor restrictions are in one column. Revenues and gains without donor restrictions are in another column. Same thing with the expenses. But then, you have this number that will always be the same. So, during the period, the entity has done whatever it needs to do to release \$95,000 of donor-restricted assets. If someone gave \$100,000 and said, "You must use this to improve the Boy Scout camp in this particular council," and they spend that money, now \$95,000 is released. You're going to, because you have to decrease that *net assets with donor restrictions* because it isn't restricted anymore, so you have a reduction there, and then, an increase on the *net assets without donor restrictions*. It's just kind of a weird thing. I will tell you, with our not-for-profits, that's the number that's always backed into. In other words, no one ever keeps an Excel schedule that dictates each single expenditure or activity that released restrictions. They just have a schedule at the end of the year that says this is what's still restricted. And they go, "Okay, we need an \$83,000 transfer," rather than identifying each one. That's typically the way that works, and that is, for whatever reason (and I can see the reasons), that is the hardest thing. People are like, "Where's that number in the general ledger?" Well, it's not. We call that a *plug*. We just have to throw it up there in the statement of activities.

Ms. Grove Casey

Let's talk about the statement of cash flows because, really, a nonprofit can run a deficit as long as they have reserves, right? But the reserves, when you come down to it, it's cash. If you don't have any cash, you can't spend more than what you have.

Mr. Oestriecher

Exactly, and we'll see that in the disclosures. But the one difference [depends on whether you are using] the direct or indirect method. I've always been a fan of the indirect method because, using the for-profit terminology, people said,

“Well, if I made \$800,000, but there’s only a \$300,000 increase in the bank, where did the other half million go?” The statement of cash flows answers that question. So, the only difference is if you’re using the indirect method, instead of starting with *net income* you start with the terminology *change in net assets*.

Then, after that, you have operating, investing, and financing activities. And it is just exactly the [same]. All of the terminology and all the calculations are exactly the same as you would have in for-profit accounting. You would typically never see distributions because, again, there’s no one to distribute anything to, so in the financing, you won’t see that. But sometimes, not-for-profits, of course, will borrow money. Some of these NGOs could even issue bonds, depending on what their purpose is. So, those are some financing activities that you may have.

And of course, investing. You do have entities that are going to either be purchasing fixed assets or literally investing in marketable equity or marketable debt security. You show those items gross, just as you would in a for-profit.

So, when you’re comparing the financial statements for for-profits to not-for-profits, this is where it’s going to be identical, except that if you’re using the indirect method, you have *change in net assets* instead of *net income*.

Ms. Grove Casey

Let’s talk about the statement of functional expenses because that’s really what sets it apart from a for-profit entity, in terms of the statements.

Mr. Oestrieher

Yes. On the boards that I serve on, it’s “Where are you spending the money? How much of it is general and administrative?” Then, after that, you get maybe fundraising, then you might have specific programs. So, that’s what we describe as a functional expense. Obviously, the broader the not-for-profit, the more functional categories you may have. Remember, we have gigantic hospital systems that are not-for-profit. And I’ve often had this conversation—and I’m probably going to get people fired up on this—when they say, “Well, gee, not-for-profit hospitals are better because they’re not trying to make a profit.” I have had family members in great not-for-profit hospitals, and I’ve had family members in for-profit hospitals. I will tell you, they charge the same. The insurance companies that are reimbursing these medical facilities don’t say, “Oh, this is a not-for-profit, so we’re only going to reimburse at a 92-percent rate instead of a 100-percent rate because they don’t have to pay taxes.” No. They run like businesses, again, but someone in the community developed it. We all know the differences between the for-profit and not-for-profit models.

But you can imagine a gigantic hospital system and how their statement of functional expenses is going to look a lot different than a local organization that maybe has a couple of functions. I’m thinking of one here in town that has expanded over the years, but their two primary, charitable focuses are helping people who are hungry—they have a little food, a place you can go every day, no questions on that, and get a meal; then, also to help battered women who are trying to get away from the people who are battering them and get back in the life game, and they help with all the counseling. So, those are the two functions and, of course, they have fundraising and they have general and administrative.

I think we’re all aware that the first thing you want to do when you look at the effectiveness of a nonprofit—the altruistic type—is how much of the money coming in is going to general and administrative? If it’s 80 percent, then all it’s doing is providing some jobs for some people. If it’s five percent, [more is going toward its mission]. In the end, when I donate money, I know that’s something that I look for. So, that is why the statement of functional expenses is so important—especially for donors because they want to see where the money is going.

So, while we’re trying to control expenses and we’re trying to do those things, remember, in a for-profit business (I ask the question because I run my CPA firm), I ask the question “Is this necessary for me? If I spend this money or if I don’t spend the money, do I have the same amount of revenues, and do I have the same efficiency and same service to my client if I don’t spend this money?” And if the answer is “Yes, I would,” then, as a business owner, I’m

not going to spend that money because I want more profit. That's what I want. At the end of the year, the partners in this firm want a nice bonus. So, our expenditures should be customer service and all those things I just mentioned. For a not-for-profit, it's "Are we spending enough in this area?" In other words, "This is how much money we have. Can we expand the Manna House? Can we expand the Hope House and these other things that are there to provide services? Because we know the demand is there." So, you look at it differently.

That gets back to that little history lesson at the beginning. We have to understand the mission of the entity. When you understand that, as the preparer of the financial statements, it helps you understand what categories of functional expenses I need. Then, how much detail do I need in there to make sure that the users of the financial statements, the stakeholders, are getting the information they need to determine if we're using our resources effectively to accomplish our mission? That is what not-for-profit financial statements should say. We get so tied down into "What do they want?" and "What's their general ledger?" and it's *us*. We're the ones that help design that, because most members of the board come from a business background, and they don't understand exactly what they're asking for. So, we have to show "This is what we're doing." That's why I think the statement of functional expenses is so, so important in the design and the level of detail, and that's where we come in.

Ms. Grove Casey

Well, one of the things that not-for-profits have that many others don't is endowment funds. Let's talk a little bit about the reporting of endowment funds.

Mr. Oestriecher

Right. Again, "What am I worried about?" If someone gives me an endowment, "Here's your million dollars. You get to use the earnings of it, and you can't go into the principal." Well, what if we have this in a mutual fund and we have a couple of bad years like we did, and we go underwater? What are we allowed to do? Well, you go back to the donor instrument and sometimes it says once you go underwater, you cannot use any money until you get back to the million. I have had them where they say, we're going to give you the endowment, but you cannot spend any of it until you have increased the value at least 10 percent, and then, you can only spend a certain amount. There cannot be stop gaps in there.

So, whatever the donor put on those endowments as those types of restrictions, you need to disclose those—and the more detailed, the better. I'm on the board of my university's foundation and our footnotes are extensive on every endowment, and you can imagine the number of endowments a university will have. It's required under GAAP that that information is there in your policy for your underwater [endowments]. If there are no donor-imposed policies, what is your entity-wide policy... on handling underwater endowments?

So, all that is disclosed and, again, in almost every case (and I've never found a case where it wouldn't be), all of the amount of the endowments are going to be part of your *net assets with donor restrictions*. That's the very definition of an endowment. One exception—sometimes, the board will endow some money and then it would *not* be within donor restrictions. But anything that's given to an entity and the donor said, "This is how I want the money endowed," that's always going to be a donor [restriction]. That's what we used to have as permanently restricted. When all this changed about five years ago and they just went to with and without donor restrictions, that's when they really beefed up the disclosures on your endowment.

So, that's one thing you'll want to make sure. Not only just reading the GAAP [disclosures]—remember that GAAP disclosure requirements are always minimal requirements. Does the user understand what this money is used for? How much we've had? How much it has earned? And how much has been used for the endowed purpose? If you can answer all those questions and the policies related to it, then you have sufficient disclosures.

Ms. Grove Casey

Let's talk about works of art and maybe historical treasures because museums are not-for-profits, a lot of times. For those types of things, the FASB came out with guidance a little while ago that described how that should be handled.

Mr. Oestrieher

Right, and there are so many we could do a five-hour thing just on not-for-profit accounting. Many of you have probably been to four-hour courses. But I did want to point out, if you have collections and works of art and historical treasures, there has been some recent guidance that came up on that and they call it a *collection*—in fact, when the standard came out, I said, “Are they talking about collecting receivables?” Then, you realize it’s a not-for-profit and they’re actually talking about a collection.

So, just make sure that your collections and your stewardship policies [are up to date], and when you deaccession (I always pronounce that wrong) a collection, generally, based on your policies, what do you do with that money? I have art and I sold the art—and this is where you insert your favorite political joke right now as to how much art is worth, depending on your relationship to various folks—and you sell that art, what do you do with that money, and then, how can it be described? So, if you have that, if you are a museum, you do want to make sure [to document that].

It doesn’t have to be art; it could be any kind of historical collection. Museums are typically not-for-profits. I don’t know if there’s ever been a for-profit museum—other than the wax museums on International drive in Orlando that I took my kids to years ago, not far from where you live. So, just make sure that if you’re a museum you’re aware of that new policy and make sure that you have your policy on your collections properly disclosed.

Ms. Grove Casey

Did you want to talk a little bit about the disclosures related to cash?

Mr. Oestrieher

Yes, that’s a new one, and it gets back to the whole purpose of the not-for-profit. What you have to do is describe—and this has probably not been as robust as the FASB wanted on some of the examples that I’ve seen out there—but basically, say you intend to spend \$800,000 next year. Where’s it going to come from? Is it going to come from donations? Is it going to come from earnings on your endowments? Earnings on your non-endowed investments? Contributions? What is your plan? Where are you going to get the money?

I remember when this standard first came out, I could just imagine the executive director (especially if that person is the main fundraiser for an entity), depending on who they’re talking to, their story is going to be a lot different. If they’re talking to their board, they’re going to say, “We’re in a great position. We’ve managed this well. We have all the money we need to fund our project.” But the next day, they are at a fundraising saying, “Folks, if you want this zoo to survive, you’ve got to open up your wallets. We’re going broke here.” And I think that’s what we’ve seen when the disclosures came out. They don’t want [to lose donors]. If you have this rosy picture, and you have all the money you’ll ever need for the next 20 years, well then, as a potential donor, I’ll say “That is great. That is fantastic that we have all the money for this zoo. I’m going to turn my donor attention now to other areas that need money.” So, it made for a very interesting dynamic, but make sure you have that disclosure in there.

Then, of course, you have all of your other general disclosures. We mentioned a couple of them with art and collections and treasures, and the cash and the endowments. But remember, the summary of significant accounting policies, fixed assets, receivables, all those things that you would have in normal for-profit GAAP financial statements, all apply to nonprofits as well.

So, hopefully, we have been able to do a good job of helping clear up some misconceptions of where you find not-for-profit GAAP, and the little nuances that we have in Section 958, but the bulk of what we have for not-for-profit, from a measurement standpoint, is very similar to U.S. GAAP for for-profits. From a presentation standpoint, it is completely different for both government and nonprofit. From a disclosure standpoint, it is very close to your for-profits, with a few extra disclosures thrown in for your nonprofit needs.

Ms. Grove Casey

Did you want to talk a little bit about the disclosures for investments?

Mr. Oestrieher

Yes. Because you obviously have a lot of investments in not-for-profits. I shouldn't say "always," but many of them do. Remember, you've still got your Level 1, Level 2, and Level 3 fair value. The items are measured, the financial instruments, and we typically would put them as either investment securities, equity securities, or debt securities. All those conventions apply. So, make sure you identify what is Level 1, Level 2, and Level 3, and you might have some things at NAV, but that's going to be very, very similar to what you'd see in for-profit entities. Again, that's where sometimes people say, "Oh, it's a not-for-profit, so I can just lump all my investments together and we'll just keep them at cost rather than fair value." No, you can't do any of that. I wanted to discuss that specifically because recently we had a peer review and my peer reviewer was telling me that he's seeing where people think that the investment stuff only applies to for-profits, but all those disclosures *and* measurement apply to nonprofits.

SUPPLEMENTAL MATERIALS

Financial Reporting Issues for Not-for-Profit Entities

By Kurt Oestrieher, CPA

Introduction

The FASB began issuing specific standards for Not-for-Profit entities over twenty years ago when they issued their first standard relating to how NFP entities should present their financial statements. That standard required presentation of net assets that were unrestricted, temporarily restricted, and permanently restricted. The statement of activities was also required to present inflows and outflows in those three categories.

Unless specifically called for, most financial statement elements are initially and subsequently accounted for using the same guidance for for-profit entities. The specific industry guidance for Not-for-Profit entities is found in ASC 958.

Nature of Not-For-Profit Accounting

While most of the measurement GAAP for not-for-profit accounting mirrors GAAP for for-profit accounting, the presentation requirements are much different due to the unique purpose of not-for-profit entities and the information that is desired by the stakeholders. Regardless of what may be written in the mission statement for a for-profit entity, the vast majority of such entities are designed to return a profit to the shareholders. However, not-for-profit entities are typically designed to achieve certain social outcomes, and stakeholders are more concerned with the nature of the types of cash inflow streams and an accounting for the expenditures made in order to achieve the mission of the entity.

In a twist, it is not the FASB that designates an entity as a not-for-profit entity, but instead the IRS makes this determination. When such status is granted by the IRS, the entity does not have to pay federal (and usually state) income taxes. The benefits of such a designation are obvious, but there are hurdles. This unique scenario will sometimes result in competitors in certain industries, such as hospitals, have vastly different presentation in their respective financial statements.

Required Financial Statements

The financial statements that are required for not-for-profit entities under United States GAAP have similarities to for-profit financial statements in the types of assets, liabilities, revenues, and expenses. However, the terminology differs, as well as some classification requirements.

Statement of Financial Position

The statement of financial position is similar to the balance sheet. Assets and liabilities are reported in homogenous groups. Assets and liabilities are not classified between current and non-current, a sharp departure from for-profit presentation. Assets and liabilities should be presented in a manner that provides relevant information about interrelationships, liquidity, and financial flexibility.

Instead of presenting equity, the term net assets is used to present the difference between assets and liabilities. Net assets are further sub-divided as net assets with donor restrictions and net assets without donor restrictions. Net assets that do not have donor restrictions may have internal board designations. Net assets that are subject to board designations may be disclosed on the face of statement of financial position or disclosed in the footnotes.

Statement of Activities

The statement of activities presents the economic inflows and outflows of the entity. The revenues and expenses are segregated by those with donor restrictions and those without donor restrictions. When donor restrictions have been satisfied (which is typically achieved by spending the resources in accordance with the restrictions), a reduction of net assets with donor restrictions is netted with a corresponding increase in net assets without donor restrictions. This release is typically presented as the last line item in the revenues section of the statement of activities.

Revenue recognition for not-for-profit is achieved through a two-pronged approach. ASC 606 is applicable for any revenue stream in which there is a contract with a customer. Examples of such revenues are payments for services rendered at a medical facility, entry fees to a zoo or a museum, or tickets to a performing arts venue. Most not-for-profits also solicit and receive donations in order to achieve its purpose. Because there is no contract with a customer in such arrangements (there are no performance obligations), ASC 958 retained existing GAAP prior to the issuance of the revenue recognition standards related to such arrangements. Typically, revenue will be recognized when received or pledged when accounted for under ASC 958. Only these types of revenues can be initially considered to have donor restrictions. Any revenue recognized under ASC 606 cannot have donor restrictions as these revenues are not donations and can be spent at the discretion of the Board.

The residual of revenues over expenses (or expenses over revenues) is referred to as increase or decrease in net assets. The term net income is not used in not-for-profit reporting.

Statement of Cash Flows

The statement of cash flows is very similar to the measurement and presentation of for-profit companies. The one difference is that when using the indirect method, the term “Increase or decrease in net assets” will be substituted for “net income.”

An entity may elect to use the direct or indirect method for reporting cash flows from operating activities. When the indirect method is used, the changes in operating assets and liabilities are presented as net amounts.

The investing and financing cash flows are presented in gross amounts. The resulting change in cash is added to or subtracted from beginning cash in order to tie to the cash presented on the statement of financial position.

Statement of Functional Expenses

The statement of functional expenses is unique to not-for-profit accounting and is arguably the most relevant financial statement to stakeholders. While raising funds and achieving revenue streams are important, donors, board members, and management are particularly sensitive to how those resources are spent. A not-for-profit entity that has unusually high administrative expenses related to its peer group will typically be perceived as inefficient.

The statement of functional expenses presents disaggregated functions as follows:

- Fundraising
- Administrative
- Program (programs should be disaggregated based on the purpose of the entity)

Expenses should be presented in sufficient detail within each function in a manner that is informative to the user of the financial statements. While specific minimums are not detailed in United States GAAP, the mantra of the more detail the better is encouraged.

Disclosure Issues

Endowment Funds

Prior to updates to the ASC, endowment funds were presented as permanently restricted net assets. Endowment funds are now a subset of net assets with donor restrictions, and detailed disclosures are required so that the user understands the nature of the endowments and the related restrictions and covenants.

An endowment is created when the donor stipulates that the initial gift is to remain intact (corpus), and the earnings from the endowment are typically used for a specific purpose. For some endowments, the donor may allow the board or management to determine the best use of the earnings.

Endowments can also be created by board designations. This is not common as most boards believe that flexibility of general donations is necessary in order to enable the organization to meet current needs when unforeseen circumstances arise. However, when an entity has excess funds on a consistent basis, it may be prudent for the board to endow some of the investible funds.

ASC 958-205-50-1 requires the following disclosures for endowments:

- Net asset classification (for example, net assets with donor restrictions or net assets without donor restrictions)
- Net asset composition (for example, board-designated endowment funds or donor-restricted endowment funds)
- Changes in net asset composition
- Spending policies
- Related investment policies
- A description of the governing board's interpretation of the law or laws that underlie the NFP's net asset classification of donor-restricted endowment funds, including its interpretation of the ability to spend from underwater endowment funds.
- A description of the NFP's policy or policies for the appropriation of endowment assets for expenditure (its endowment spending policy or policies), including its policy, and any actions taken during the period, concerning appropriation from underwater endowment funds.
- A description of the NFP's endowment investment policies, including all of the following:
 1. Return objectives and risk parameters
 2. How return objectives relate to the NFP's endowment spending policy or policies
 3. The strategies employed for achieving return objectives.

Works of Art and Historical Treasures

Works of art and historical treasures that do not meet the definition of a collection must be either presented separately on the face of the statement of financial position or disclosed in the footnotes.

An NFP that does not recognize and capitalize its collections or that capitalizes collections prospectively shall describe its collections, including their relative significance, and its stewardship policies for collections. If collection items not capitalized are deaccessioned during the period, it also shall describe the items given away, damaged, destroyed, lost, or otherwise deaccessioned during the period or disclose their fair value.

A collection-holding NFP shall disclose its organizational policy for the use of proceeds from deaccessioned collection items, including whether those proceeds could be used for acquisitions of new collection items, the direct care of existing collections, or both. If the collection-holding entity allows proceeds from deaccessioned collection items to be used for direct care, the entity shall disclose its definition of direct care.

Cash and liquidity

A not-for-profit entity shall disclose the following related to cash and liquidity

- Relevant information about nature and amount of limitations placed on cash
- Contractual limitations on the use of particular assets
- Quantitative and qualitative information related to availability of cash to meet liquidity needs for general expenditures within one year of the balance sheet date

General disclosures

In addition to the unique disclosures described above, a not-for-profit entity shall disclose all of the disclosures required in United States GAAP for other for-profit entities, including:

- Summary of significant accounting policies
- Fixed assets
- Debt and equity securities
- Receivables
- Revenues
- Pension obligations
- Subsequent events
- Concentrations
- Related party transactions
- Going concern

Sample Financial Statements

**Sample Not-For-Profit Entity
Statement of Financial Position
June 30, 2023**

Assets

Cash and cash equivalents	\$ 85,000
Prepaid expenses	26,000
Short term investments	145,000
Property, plant, and equipment, net	265,000
Long-term investments	<u>750,000</u>
Total assets	<u>\$ 1,271,000</u>

Liabilities and Net Assets

Accounts payable	\$ 43,000
Notes payable	<u>95,000</u>
Total liabilities	<u>138,000</u>
Net assets	
Without donor restrictions	683,000
With donor restrictions	<u>450,000</u>
Total net assets	<u>1,133,000</u>
Total liabilities and net assets	<u>\$ 1,271,000</u>

Sample Not-For-Profit Entity
Statement of Activities
For the year ended June 30, 2023

	<u>Without Donor Restrictions</u>	<u>With Donor Restrictions</u>	<u>Total</u>
Revenues, gains, and other support:			
Contributions	\$ 85,000	\$ 150,000	\$ 235,000
Grants	-0-	165,000	165,000
Dues and fees	13,000	-0-	13,000
Investment gains	25,000	83,000	108,000
Net assets released from restrictions14,000	(14,000)	-0-	
Satisfaction of program restrictions8,000	(8,000)	-0-	
Expiration of time restrictions	25,000	(25,000)	-0-
Satisfaction of donor restrictions	<u>153,000</u>	<u>(153,000)</u>	<u>-0-</u>
Total net assets released from restrictions	<u>200,000</u>	<u>(200,000)</u>	<u>-0-</u>
Total revenues, gains, and other support	<u>323,000</u>	<u>198,000</u>	<u>521,000</u>
Expenses			
Program A	115,000	-0-	115,000
Program B	86,000	-0-	86,000
Program C	53,000	-0-	53,000
Management and general	55,000	-0-	55,000
Fundraising	<u>10,000</u>	<u>-0-</u>	<u>10,000</u>
Total expenses	<u>319,000</u>	<u>-0-</u>	<u>319,000</u>
Change in net assets	4,000	198,000	202,000
Net assets, beginning of year	<u>679,000</u>	<u>252,000</u>	<u>31,000</u>
Net assets, end of year	<u>\$ 683,000</u>	<u>\$ 450,000</u>	<u>\$1,113,000</u>

Sample Not-For-Profit Entity						
Statement of Functional Expenses						
For the year ended June 30, 2023						
	Program Services				Supporting Services	
	<u>Program A</u>	<u>Program B</u>	<u>Program C</u>		<u>Administrative</u>	<u>Fundraising</u>
Compensation	65,000	52,000	30,000		32,000	-
Employee benefits	6,000	5,200	3,000		3,200	-
Supplies	3,500	4,000	1,500		2,200	10,000
Rent	7,000	7,000	4,000		4,000	-
Maintenance	1,400	1,800	800		100	-
Insurance	3,500	3,200	2,000		2,000	-
Travel	14,000	6,200	3,000		3,500	-
Telephone	3,000	3,000	2,400		2,000	-
Other	<u>11,600</u>	<u>3,600</u>	<u>6,300</u>		<u>6,000</u>	<u>-</u>
Total expenses	<u>115,000</u>	<u>86,000</u>	<u>53,000</u>		<u>55,000</u>	<u>10,000</u>

Summary

The stakeholders of not-for-profit entities need financial information that is not necessarily similar to the needs of for-profit entities. To address those needs, the AICPA created a presentation and disclosure framework that was eventually modified by the FASB and adopted into the Accounting Standards Codification. A preparer of not-for-profit financial statements needs to understand ASC 958 and apply the guidance as necessary.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the nature of not-for-profit accounting.
2. Discuss the required financial statements for not-for-profit entities.
3. Discuss the required disclosures for not-for-profits.

B. Suggested Answers to Discussion Problems

1. While most of the measurement GAAP for not-for-profit accounting mirrors GAAP for for-profit accounting, the presentation requirements are much different due to the unique purpose of not-for-profit entities and the information that is desired by the stakeholders. Regardless of what may be written in the mission statement for a for-profit entity, the vast majority of such entities are designed to return a profit to the shareholders. However, not-for-profit entities are typically designed to achieve certain social outcomes, and stakeholders are more concerned with the nature of the types of cash inflow streams and an accounting for the expenditures made in order to achieve the mission of the entity.
2. The statement of financial position is similar to the balance sheet. Assets and liabilities are reported in homogenous groups. Assets and liabilities are not classified between current and non-current, a sharp departure from for-profit presentation. Assets and liabilities should be presented in a manner that provides relevant information about interrelationships, liquidity, and financial flexibility. Instead of presenting equity, the term *net assets* is used to present the difference between assets and liabilities. Net assets are further sub-divided as net assets with donor restrictions and net assets without donor restrictions. Net assets that do not have donor restrictions may have internal board designations. Net assets that are subject to board designations may be disclosed on the face of statement of financial position or disclosed in the footnotes.

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The statement of cash flows is very similar to the measurement and presentation of for-profit companies. The one difference is that when using the indirect method, the term “Increase or decrease in net assets” will be substituted for “net income.” An entity may elect to use the direct or indirect method for reporting cash flows from operating activities. When the indirect method is used, the changes in operating assets and liabilities are presented as net amounts.

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3. NFPs have some unique disclosure issues in addition to the ones for profit entities have. These disclosures include those for endowments, works of art or treasures, and liquidity. ASC 958-205-50-1 requires the following disclosures for endowments:
- Net asset classification (for example, net assets with donor restrictions or net assets without donor restrictions)
 - Net asset composition (for example, board-designated endowment funds or donor-restricted endowment funds)
 - Changes in net asset composition
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 - Related investment policies
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PART 2. AUDITING

Implementing Quality Management Standards

With the issuance of SQMS No. 1, the AICPA has mandated firms design, implement, and operate a risk-based approach to their quality management systems. Not only do firms need to implement a new risk-assessment process related to quality management, the system needs to be annually assessed beginning one year after the implementation. New systems of quality management are required to be in place by December 15, 2025.

For more on preparing for the new quality management standards, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk a little bit about the new quality management standards and preparing to implement those. Why did the AICPA feel the need to update the quality management standards?

Ms. Louis

Well, a large part of it was to make a more risk-based approach to what you're doing in designing, implementing, and operating the various components that you would have in a system of quality management. What this means, then, is that it can be tailored to the nature and circumstances of your firm, but it also can be tailored to the specific types of engagements that your firm applies. This helps in ensuring that each firm can customize their system of quality management to the specifics of their practice. What would be important for maintaining quality for the particular nature of the services that they apply, and to make sure that it is customized in both identifying what risks they have to manage, and how they might respond to those specific risks.

Ms. Grove Casey

When are these standards effective?

Ms. Louis

The new quality management standards themselves are going to be effective for a firm's accounting and auditing practice as of December 15, 2025. So, that's when you're supposed to have them written and be ready to place them into operation.

Ms. Grove Casey

Could you give us an overview of the elements for a well-designed system of quality management?

Ms. Louis

Yes. The various components—there are eight of them—some of them are things that if you look at COSO, the Committee of Sponsoring Organizations, they have their *Internal Controls--Integrated Framework*, some of them are pretty consistent with some of the components that you would see there. The fact that there does need to be a sense of governance and leadership, there does need to be information and communication, there needs to be monitoring, and there needs to be a risk assessment process. But then, there also needs to be the specific activities that you're doing as you are performing your engagements, accepting and continuing clients, as well as specific engagements [with] clients. Then, in addition, thinking about relevant ethical requirements that exist. So, looking at what would be important in a system of internal controls over quality management that [considers] our profession and the things that we need to do in order to have quality in our attest and audit services.

Ms. Grove Casey

Could you tell us a little bit more about the process for risk assessment?

Ms. Louis

The process, in essence, has three major steps. The first step in the process is going to be what are the specific quality objectives that we need to focus on as we think about what objectives we have related to accepting a client. What are the objectives that should exist? And then, what could be a risk that could keep us from achieving that objective? Those are commonly going to be referred to as *quality risks*. So, we have to think about the quality risks that are related to the quality objectives of the different components of this system. Then, the third step in the process would be to put together a response to address the quality risks, thinking about [ways] to manage this risk to what we would believe to be an appropriate response. The nature, the timing, the extent of the response is also still going to be risk-based in the design and implementation of our system.

Ms. Grove Casey

Are all risks faced by a CPA firm deemed to be quality risks that need to be managed?

Ms. Louis

As we think about risk, part of it would be, no, not every risk is going to meet the definition of a quality risk. We have to think about what's reasonable and practicable for a firm to do. Identifying and assessing every possible risk and designing and implementing a response to every possible risk would not be cost beneficial. Quality risks are risks that have a reasonable possibility of occurring and, if it's reasonably possible of occurring, it's also reasonably possible that individually, or in the aggregate with other risks, it would adversely affect our ability to achieve one or more quality objectives. So, it goes along with thinking about a risk-based approach. Just like when we do financial statement audits, there is a risk-based approach to the audit of what assertions are relevant for us to test. It's going to be similar as we are designing internal controls. We have different resources that have limitations to them, and we focus our resources in a way that is prudent as we think about how and the degree to which a condition or event or circumstance might adversely affect our achievement of quality objectives.

Ms. Grove Casey

Are quality objectives required to be broken down into sub-objectives for an effective assessment?

Ms. Louis

It is not required that you do that, but as you're preparing for this process it might be helpful for you to do that. There may be sub-objectives that I can think about in designing some of my quality risks. So, certainly, the level of detail or disaggregation that you decide to use should be tailored to your circumstances.

Ms. Grove Casey

Let's talk about some factors that should be considered in establishing quality objectives.

Ms. Louis

As we think about events, conditions, circumstances, [consider] the size of your firm, the characteristics of your firm resources, how geographically dispersed you are, focus on the complexity and operating characteristics of the firm. Also, things like your strategic goals, your industry specialization, and how long you've been offering certain services. Strategic and operational decisions and actions about your business model also could create a concern. We need to think about how you are structuring your organization. Are you using outside service providers that might create a concern? There are laws, regulations, and standards that we have to comply with. All of these factors would be something that would affect what a quality objective might be.

Ms. Grove Casey

What are some examples of potential quality risks that could get in the way of achieving those quality objectives?

Ms. Louis

Well, a specific risk might be to consider, if I've got geographically dispersed locations of my firm, how do I get a consistent culture to be maintained? It might be that as we think about the services we provide, there may be audit and non-audit services, for example, that we apply to the same clients and we breach independence requirements. There may be differences of opinion within a particular engagement and those differences of opinion aren't taken to the right level of management or leadership of the firm to resolve them. It could be that an engagement is not properly planned or supervised and there are not proper levels of review, or there is information that is not properly communicated—particularly as we deal with remote working situations. These are all examples of things that could go wrong. These are things that could go wrong and could affect our ability to do quality work.

Ms. Grove Casey

What are some possible responses that may be designed to respond to the quality risks that were identified?

Ms. Louis

Part of that might be something like having documented policies and procedures in writing that we can disseminate to our firm's personnel. It might be that we structure an org chart and that we have job descriptions as we're assigning roles, responsibilities, and authority within our organization. It could be that we make sure we have a designated person in our firm who is the go-to person if you're concerned about ethical requirements and independence, so they are specifically trained in providing guidance, answering questions, and resolving matters related to complying with our Code of Professional Conduct. So, those are things that a firm can specifically do. They can take action that will help manage the risks that we talked about in the previous question.

Ms. Grove Casey

Let's talk about some practical implementation tips that a firm may consider beyond what you just mentioned.

Ms. Louis

Right. So, part of it is just making sure I'm understanding the goal as we think about the overall objective. The overall objective is to make sure that we design and implement a system of quality management that makes sure that our accounting and auditing practices are done in a high-quality way. That's our overall goal.

Ms. Grove Casey

Maybe communicating that, too.

Ms. Louis

We need to keep an eye on that ball; that is the goal and the objective. And as we give ownership of this process to lead this implementation team, we want to make sure that whoever we're assigning this role to is somebody that understands that goal, and also can look through and understand what human, intellectual, and technical resources we really need to have in order to successfully implement this overall goal, this overall plan. Then, to also understand that we need to put together a timeline. We know that there's this deadline out there that we have to achieve and put together a reasonable plan that will help us properly implement this goal.

Ms. Grove Casey

Are there any tips specific to the risk assessment brainstorming sessions?

Ms. Louis

Well, that's going to be a large part of this. It's a risk-based approach. So, we do need to go through and figure out, first of all, what are our quality objectives, and then, what are the things that could go wrong? We need to potentially have multiple brainstorming sessions as we focus on each of the different components—resources, engagement acceptance and continuance, those things. Think about these components of what they've said are important to a quality management system. I need to now think through, what are the risks that could keep us from doing well at that? It may be necessary to involve your HR department or your IT function as we're brainstorming and gathering information, capturing the quality objectives for each component and the risks that we've identified. Then also, think about the relative significance of each of those risks. What's the likelihood and magnitude of concerns associated with these risks that we're brainstorming about?

Ms. Grove Casey

How does what the firm is currently doing with quality control impact the process?

Ms. Louis

All firms are already required to comply with the quality control standards that are the precursor to these quality management standards. The quality management standards have been enhanced and clarified in general. So, we can't just assume that what we were doing before meets the goals and objectives of this new risk-based approach. But certainly, as we think through how we're going to respond to these risks, we can use what we know already related to the current risks that we've identified and the current responses that we have. But remember that risk is evaluated *before* we think about the response. So, don't think that a quality risk doesn't exist just because I already have a control in place. You're basically starting over. I've got to build the system from the ground up and show where I've gone through this in a step-by-step, methodical process. You can't just skip to step three; you've got to go through steps one and two to justify that what you're doing in step three is sufficient and appropriate given your facts and circumstances.

Ms. Grove Casey

How detailed does the risk assessment process need to be?

Ms. Louis

Well, it needs to be enough that I can decide which of my risks are actually the quality risks. The quality risks are ones where I think that there's a likelihood and magnitude that it merits a response. And we want to make sure that we're not being too detailed, too granular, where I'm identifying way too many risks that aren't really quality risks, but I also don't want to be too high level. It is going to be a matter of judgment in the end on how to strike that right balance.

So, it is important we understand that there is *no* requirement to document every single risk that we consider. Now, it would be prudent to maybe track some of the borderline risks, things that aren't quite quality risks yet, but I want to keep track of them because, in aggregate or in the future, things could change if something is on the borderline. But I'm not expected to have perfection in looking at my documentation. You need to ensure that from a cost-benefit point of view, you are capturing those things that you think are prudent to capture, and you can justify that this was a thoughtful approach to designing our system of quality management.

Ms. Grove Casey

While we don't have to track every single risk that's there, is there a minimum number of risks that should be identified?

Ms. Louis

There's not a set minimum, either. Now remember, you are going to have to think about the risks for each of the components and the quality objectives you've established for that component. But it's going to depend on the nature and circumstances of each firm. It also is important to understand that when you start designing your responses, that a response can cover many risks. If you're finding that a response is covering lots of risks, that could be a signal that you're being too granular. You might want to start grouping your risks if it's hitting too many things.

Now, it's fine that a same response covers multiple things, but that is a mechanism that you may find [helpful] in the course of this process. I want to make sure that I'm not being too detailed, but I also want to make sure that I do [consider areas] where there may be a risk that doesn't yet have a response, or I have a response that hasn't been tied to a risk. So, if there is something that we've normally done and I haven't linked it to a risk yet, that might mean that you haven't identified enough quality risks. Often, it's a learning curve as you go through the process. You're going to start by using your judgment on what is the right balance that I'm dealing with.

Ms. Grove Casey

Could you suggest a general format for documenting the process?

Ms. Louis

It would be appropriate if I can see, did you do a gap analysis? Mapping risks to controls, and responses to these quality risks. I want to make sure that it's in enough detail that I can show the risk and the response, and to make sure that a risk is tied to an appropriate response, but to also make sure that responses I might have are linked back to a quality risk. That, ultimately, is something that also needs to be in a format that we can update as we have facts and circumstances within our firm that evolve over the course of time. I need to revisit my system to see whether I might want to change things because there may be new risks that evolve, or risks that go away, that merit me redesigning my risk responses.

Ms. Grove Casey

Can you describe more about the role of governance and leadership in this process?

Ms. Louis

A large part of it is to make sure that you are promoting a culture that recognizes the essentialness of quality in performing whatever engagements we're doing. What is the tone? What is the sense of accountability that is in place specific to quality management and what it is that we're doing? Also, our strategic decisions and actions as we think about our financial and operational priorities. There does need to be ultimate accountability and responsibility for quality management—that there is somebody in charge. We also need to demonstrate a commitment to quality through our culture that reinforces the consistency of quality at the engagement-specific level, as well.

Ms. Grove Casey

What's the purpose of the relevant ethical requirements element of the process?

Ms. Louis

It's going to continue to be as it was before—that we have reasonable assurance that our firm and the people who work in our firm comply with relevant ethical requirements as they're satisfying their professional responsibilities. So, it's the firm and its personnel, but it also may include a network, and it may include outsourced providers or consultants that we may use. We're really thinking about who needs to comply with ethical requirements and to what degree. How are we ensuring that these individuals and the firm as a whole can say, "Yes, we are comfortable. We've complied with whatever is relevant to us, whether it's the Code of Professional Conduct, whether it's Government Auditing Standards, whatever it is. We feel comfortable."

Ms. Grove Casey

What is important for the acceptance and continuance element?

Ms. Louis

Well, the purpose of this is to make sure that as we associate ourselves with clients, that they are clients we should associate with. But also, for specific engagements [with] the clients, we feel that there is reasonable assurance that we're making appropriate judgments about whether to accept or continue relationships or engagements. That really is a key element in quality management and also professional liability risk management as we're making informed decisions about these matters. They want to make sure that the financial and operational priorities of the firm don't lead to inappropriate judgments about whether to accept or continue a specific client relationship or a specific engagement.

Ms. Grove Casey

Let's talk about the purpose of the engagement performance element.

Ms. Louis

This is where we're giving reasonable assurance that engagements themselves are consistently performed in accordance with applicable professional, regulatory, and legal requirements, and that the reports we're issuing are appropriate in the circumstances. Whether it's a review or an audit or agreed-upon procedures, as we're issuing reports, there is reasonable assurance that these reports are appropriate; there is reasonable assurance that the work was done in a high-quality way. So, think about the engagement teams themselves and how they understand their responsibilities and their connections to this engagement. Also, think about the nature, timing, and extent of direction, supervision, and review. It's making sure that we're exercising appropriate professional judgment, and that we're maintaining professional skepticism. It's making sure that we handle differences of opinion and consultation on difficult or contentious matters as needed. These are things that would fall under engagement performance, which also includes the engagement documentation itself.

Ms. Grove Casey

Well, it makes sense that a commitment to resources would be critical to this effort's success. What are some examples of the resources that should be considered in this process?

Ms. Louis

Make sure that the firm has reasonable assurance that it is appropriately obtaining, developing, using, allocating, and assigning resources in a timely way to ensure that the system of quality management can operate effectively. So, we have to make sure that we can design, implement, and place in operation a system of quality management, and the firm is ensuring that we're giving the resources in a timely way for that to occur. [For example] technical resources, the audit tools or IT applications that the firm uses; and intellectual resources, like our templates and our practice aids. And our human resources—as we think about the employees that we have, and the consultants or the outsourced providers that we use. In addition, think about engagement quality control reviewers and other resources that we might need to have. So, it is something that does [consider] the variety of resources that we rely on in those different categories. What are technological resources, the human resources, and the intellectual resources that we need to make sure are supporting our ability to have a well-designed and effectively operating system of controls?

Ms. Grove Casey

Let's talk about the importance of information and communication to this process because it would seem kind of critical—especially if you're trying to balance those resources.

Ms. Louis

Right, and similar to the COSO *Internal Control—Integrated Framework*, we’re just talking about the importance of having a continuous flow of information and communication, both within the firm and with appropriate external parties that also might have information that would be useful to us. It encourages us to ensure that we’re looking for and seeking information. We’re promoting proactive communication in a way that helps us make sure that we’ve got the data and the information that we need in order to have a well-functioning system of quality management.

Ms. Grove Casey

So, the final element that we haven’t yet discussed is the monitoring and remediation process. What important considerations should a firm make related to this element?

Ms. Louis

Well, we want to make sure that, first, we can identify deficiencies in our systems in a timely way. We do need to monitor the entire system of quality management. Where is it that we’ve put a response in place that doesn’t seem to be properly managing our quality risks, either in the design of it, the implementation of it, or the operating effectiveness of it? So, it is important that we design specific monitoring activities, and what is appropriate as far as monitoring activities is going to be dependent on firm-specific factors for what would be prudent or reasonable to include.

Ms. Grove Casey

While every situation is different and, of course, we have the [issue that] so many answers are “It depends”—it depends on the firm, it depends on the clients, it depends on the engagements you’re performing for those clients—does that monitoring and remediation component include any specific monitoring requirements?

Ms. Louis

Well, there is a requirement to inspect completed engagements and partners that are involved, and that they are inspected on a cyclical basis. You determine your inspection criteria, and you determine how often to select engagements for specific partners or specific industries. How frequently do we look at things in a cyclical way? But you do need to have a plan where there are internal inspections and internal monitoring that’s appropriate in our circumstances. It also has a requirement to make sure that we do evaluate the things that we find, and to think about deficiencies in our system of quality management, to look for root causes of identified deficiencies, and to put together a corrective action plan that is appropriate given the severity and the pervasiveness of these root causes and the resulting deficiencies that evolve. It also would be important that you document your process in going through that assessment.

SUPPLEMENTAL MATERIALS

Preparing for Implementing the New Quality Management Standards

By Jennifer F. Louis, CPA

Background

Statement on Quality Management Standards (SQMS) No. 1, *A Firm's System of Quality Management*, issued by the AICPA requires the firm to apply a risk-based approach in designing, implementing, and operating the components of the system of quality management.

In applying a risk-based approach, the firm is required to consider the nature and circumstances of both the firm and the engagements performed by the firm.

A risk-based approach helps firms identify and address risks specific to their practice and creates a more scalable approach to quality for all firms. The risk-based approach comprises:

- Establishing quality objectives (the desired outcomes relating to the components of the system to be achieved by the firm);
- Identifying and assessing quality risks (a risk that has a reasonable possibility of occurring and, individually or in combination with other risks, adversely affecting the achievement of one or more quality objectives); and
- Designing and implementing responses (policies or procedures designed and implemented by the firm to address one or more quality risks).

A firm must customize the risks and responses to the nature of a firm's practice to follow the standards. Plus, it must be what is most effective and efficient for a firm's practice. The standard's approach emphasizes the responsibility of firm leadership for proactively managing quality and provides flexibility to deal with differences in the size of firms and the nature of the services they provide.

The approach requires a firm to customize the design, implementation, and operation of its system of quality management (SOQM) based on the nature and circumstances of the firm and the engagements it performs. The standard also has an increased emphasis on a continual flow of remediation and improvement.

A firm's risk assessment should be updated when changes in the nature and circumstances of the firm or its engagements occur. An incomplete or out-of-date risk assessment can have a significant effect on the system of quality management.

Effective Date

The new Statement on Quality Management Standards are effective for a firm's accounting and auditing practice as of December 15, 2025.

Overview of Structure

An SOQM addresses the following eight components, which are highly integrated and do not function in isolation:

1. The firm's risk assessment process
2. Governance and leadership
3. Relevant ethical requirements

4. Acceptance and continuance of client relationships and specific engagements
5. Engagement performance
6. Resources
7. Information and communication
8. The monitoring and remediation process

The objective of the firm is to design, implement, and operate an SOQM for its accounting and auditing practice that provides the firm with reasonable assurance that:

- The firm and its personnel fulfill their responsibilities in accordance with professional standards and applicable legal and regulatory requirements and conduct engagements in accordance with such standards and requirements, and
- Engagement reports issued by the firm are appropriate in the circumstances.

Risk Assessment Process

The purpose of the risk assessment process element of an SOQM is to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks.

Risk assessment is a three-step process:

1. Establish quality objectives. The standard requires the firm to establish specific quality objectives for each component except risk assessment and monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the SOQM. However, the firm may not find it necessary to establish additional quality objectives.
2. Identify and assess risks to the achievement of the quality objectives (commonly referred to in the standard as quality risks), which involves:
 - Understanding the factors (e.g., the conditions, events, circumstances, actions, or inactions) that may adversely affect the achievement of the quality objectives, and
 - Considering how and the degree to which the factors may adversely affect the achievement of the quality objectives, which does not require formal ratings or scores.
3. Design and implement responses to address the quality risks. The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks. Certain responses are specified in the standard; however, the specific responses required by the standard will not be sufficient for the firm to address all its quality risks.

A risk arises from how, and the degree to which, a condition, event, circumstance, action, or inaction may adversely affect the achievement of a quality objective. The firm is not required to document the consideration of every condition, event, circumstance, action, or inaction that may give rise to a quality risk.

Not all risks meet the definition of a quality risk. It is not reasonable or practicable for the firm to identify and assess every possible risk and to design and implement responses for every risk. Accordingly, the standard requires the firm to focus on identifying "quality risks."

Quality risks have the following criteria:

1. The risk has a reasonable possibility of occurring.
2. The risk has a reasonable possibility of, individually or in combination of other risk, adversely affecting the achievement of one or more quality objectives.

The firm might find it helpful to break the quality objectives into sub-objectives, although that is not required. If a firm has sub-objectives, there may be circumstances in which a risk has a reasonable possibility of adversely affecting the achievement of the sub-objective but does not have a reasonable possibility of adversely affecting the achievement of a quality objective. This risk would not be considered a quality risk.

Firms are also required to identify information indicating the need for additions or modifications to previously identified quality objectives, quality risks, or responses.

Factors That Impact Quality Objectives and Quality Risks

The following are examples of conditions, events, circumstances, actions, or inactions that a firm should understand to establish quality objectives:

- The complexity and operating characteristics of the firm (such as size, geographical dispersion, characteristics of firm resources)
- The strategic and operational decisions and actions, business processes, and business model of the firm (such as financial and operational priorities, strategic goals, industry specialization, new service offerings)
- The characteristics and management style of leadership (such as composition and tenure of firm leadership, methods for motivation, distribution of authority)
- The resources of the firm, including the resources provided by service providers (such as staff profile and structure, use of technology, allocation of financial resources, nature of service providers)
- Law, regulation, professional standards, and the environment in which the firm operates
- The nature and extent of the network requirements and network services
- The types of engagements performed by the firm and the reports to be issued
- The types of entities for which engagements are undertaken

The following are examples of possible quality risks:

1. How a consistent culture is maintained throughout the firm because of the dispersion of the firm and the leadership responsibilities.
2. The firm breaches independence requirements regarding nonaudit services.
3. Personnel do not bring differences of opinion that involve leadership to the attention of the firm.
4. Engagement personnel are not appropriately directed and supervised and their work is not appropriately reviewed.
5. Information is not communicated appropriately to engagement teams working remotely, such that engagement teams are unable to understand and carry out their responsibilities in performing the engagement.

6. The firm inappropriately accepts a client relationship or specific engagement, given that the firm has excess staff capacity.
7. The network does not appropriately consider requirements regarding independence in developing software and the firm is not alerted when there is an independence breach.
8. The firm does not have appropriate intellectual resources to support these engagements and engagement teams use intellectual resources that do not take into account laws and regulations related to emissions.
9. The engagement teams performing the compilations do not undertake appropriate consultation, given that they have not previously needed to consult on complex financial statement disclosures.
10. Personnel lack the appropriate knowledge or experience of relevant accounting standards applicable to that industry.

The following are examples of possible responses to quality risks:

1. The organizational structure and assignment of roles, responsibilities, and authority is appropriate to enable the design, implementation, and operation of the firm's SOQM.
2. The firm documents its QM policies and procedures and communicates them to the firm's personnel.
3. The firm does not allow financial and operational priorities to override the quality of the work performed and assigns management responsibilities accordingly.
4. A person with appropriate authority is named responsible for staying informed on relevant ethical requirements; providing guidance; answering questions; monitoring compliance; and resolving matters with respect to independence, integrity, and objectivity.
5. The firm provides its personnel with a list of all entities with which firm personnel are prohibited from having a business relationship and informs them on a timely basis about any changes in the firm's clients to which independence policies apply.
6. The firm informs personnel of the firm's policies and procedures for accepting and continuing clients, through discussion or distribution of the firm's policies and procedures manual.
7. Professional personnel have been informed that they are expected to be familiar with the firm's policies and procedures for the acceptance and continuance of clients, including who in the firm is authorized to accept engagements on behalf of the firm. Such policies and procedures state that the firm's clients should not present undue risks to the firm, including damage to the firm's reputation.
8. If the engagement is for a level of service that the firm is not currently providing (for example, reviews or audits), the firm considers the implications for obtaining the necessary competency and the implications for peer review.
9. The firm provides personnel with the firm's practice aids that prescribe the factors the engagement team should consider in the planning process and the extent of documentation of those considerations.
10. For each engagement, there is evidence of appropriate review of documentation of the work performed, conclusions reached, the financial statements, and the report.
11. When the firm does not have suitably qualified personnel to perform the engagement quality review, the firm engages a suitably qualified external person to perform the EQ review.

Practical Implementation Tips

Determine who within the firm will take ownership and lead the implementation process. Also determine what other human, intellectual, and technical resources will be needed for successful implementation.

Develop an appropriate timeline for performing the risk assessment and designing and implementing responses.

Talk with peer reviewers for advice about implementation plans.

Plan one or more risk assessment brainstorming sessions to determine the order in which the components will be assessed and who should participate. Depending on the component and the size of a firm, it may be necessary to involve the firm's other departments (such as IT, HR, and risk advisory). The goal is to identify and assess the risks, not to develop responses yet. Plan for more brainstorming as more information is gathered, as risk assessment is meant to be an on-going process.

Develop a template that includes the quality objectives for each component, along with an ability to capture the brainstorming of risks identified, risk significance, and planned responses.

Brainstorm risk identification, considering what could go wrong from a quality perspective. This can be impacted by considering what the firm is currently doing (or should be doing) to make sure things go right.

Consider any information the firm may have related to current quality risks (e.g., information provided to insurance carriers).

Remember that risk is evaluated before the effect of controls (i.e., quality responses, which are policies and procedures). Do not think that a quality risk doesn't exist because the firm already has effective controls to mitigate it. Evaluate risks as if starting to build an SOQM from the ground up.

For the identified risks, assess them for likelihood and magnitude. Decide which risks are quality risks. It may take a few attempts to determine the appropriate level for quality risks to avoid being too granular or too high level in their identification.

Do just enough to know that the risk will warrant a response and move on. Remember that there is no requirement to document every risk that is considered. However, it may be prudent to track borderline risks that don't quite rise to quality risks for reassessment in the future.

Don't worry about perfection in documentation (such as likelihood, magnitude, or reasons for the risk) or matching risks to objectives. Formal ratings or scores are not required.

The number of risks a firm should identify is a matter of professional judgment and depends on the nature and circumstances of the firm.

- If a firm has many risks that are covered by the same responses (for example, policies and procedures), that is a sign that you may be too granular, and you may wish to group the risks.
- If a firm has not identified risks associated with all responses (for example, policies and procedures), that may be a sign that you haven't identified enough quality risks.

Perform a gap analysis for the quality risks identified by mapping them to current controls (commonly referred to as "responses to quality risks"). Identify quality risks without appropriate responses, as well as any current responses that do not map to a quality risk.

Design and implement new responses for risks that are not addressed. Consider discontinuing current responses that do not map to a quality risk.

A response may address multiple quality risks across various components.

Document the risk assessment process. This documentation does not need to be very detailed; it should describe the process (i.e., what the firm did to identify and assess quality risks) without including every risk identified.

Governance and Leadership

The purpose of the governance and leadership element of an SOQM is to promote an internal culture based on the recognition that quality is essential in performing engagements. The governance and leadership section addresses the expected behavior of firm leadership in setting the tone at the top, the appropriate qualifications of leadership, and holding leadership accountable through performance evaluations. The standard also addresses the importance of quality in the firm's strategic decisions and actions (including financial and operational priorities) as well as firm leadership's ability to influence decisions about the firm's resources.

The firm is required to assign ultimate responsibility and accountability for the SOQM to the firm's CEO, managing partner (or equivalent), or if appropriate, managing board of partners (or equivalent). In addition, the firm is required to assign the following to designated individuals:

- Operational responsibility for the SOQM.
- Operational responsibility for specific aspects of the SOQM, including compliance with independence requirements and the monitoring and remediation process.

SQMS No. 1 emphasizes the firm's commitment to quality through a culture that reflects the firm's role in serving the public interest through consistent quality engagements. Leadership demonstrating a commitment to quality through its actions and behaviors reinforces the responsibility that all personnel hold for quality relating to the performance of engagements and activities within the SOQM.

Relevant Ethical Requirements

The purpose of the relevant ethical requirements element is to provide the firm with reasonable assurance that the firm and its personnel comply with relevant ethical requirements when performing professional responsibilities. The relevant ethical requirements component addresses responsibilities regarding ethical requirements for the firm and its personnel as well as others in the firm's network.

The following quality objectives should be established relating to the firm and its personnel:

- Understand the relevant ethical requirements to which the firm and the firm's engagements are subject.
- Fulfill their responsibilities in relation to the relevant ethical requirements to which the firm and the firm's engagements are subject.

The firm should also ensure that others (including the network, network firms, individuals in the network or network firms, or service providers) who are subject to the relevant ethical requirements (such as independence or principles of confidentiality) to which the firm and the firm's engagements are subject:

- Understand the relevant ethical requirements that apply to them, and
- Fulfill their responsibilities in relation to the relevant ethical requirements that apply to them.

Acceptance and Continuance of Client Relationships and Specific Engagements

The purpose of the acceptance and continuance of client relationships and specific engagements component is to provide reasonable assurance that the firm makes appropriate judgments about whether to accept or continue a client relationship and whether to perform a specific engagement.

A firm's acceptance and continuance policies represent a key element in quality management, while also mitigating litigation and business risk. This component also addresses quality objectives for firms around client acceptance and continuance decisions.

These objectives include judgments by the firm to accept or continue a client relationship or specific engagement based on:

- Information obtained about the nature and circumstances of the engagement.
- Information obtained about the integrity and ethical values of the client, including the identity and business reputation of the client's principal owners, key management, and those charged with its governance.
- The firm's ability to perform the engagement in accordance with professional standards, and applicable legal and regulatory requirements.

SQMS No. 1 also emphasizes that the financial and operational priorities of the firm should not lead to inappropriate judgments about whether to accept or continue a client relationship or specific engagement.

Engagement Performance

The purpose of the engagement performance element is to provide the firm with reasonable assurance that engagements are consistently performed in accordance with applicable professional standards and regulatory and legal requirements and that the firm issues reports that are appropriate in the circumstances. The engagement performance section provides quality objectives that firms should establish to obtain reasonable assurance that high-quality performance is being attained in the firm's engagements.

Establishing and maintaining quality objectives such as the following help the firm in obtaining reasonable assurance relating to the engagement performance element:

- Engagement teams understand and fulfill their responsibilities in connection with the engagements, including, as applicable, the overall responsibility of engagement partners for managing and achieving quality on the engagement and being sufficiently and appropriately involved throughout the engagement.
- The nature, timing, and extent of direction and supervision of engagement teams and review of the work performed is appropriate based on the nature and circumstances of the engagements and the resources assigned or made available to the engagement teams; and the work performed by less experienced engagement team members is directed, supervised, and reviewed by suitably experienced engagement team members.
- Engagement teams exercise appropriate professional judgment and, when applicable to the type of engagement, maintain professional skepticism.
- Consultation on difficult or contentious matters is undertaken, and the conclusions agreed to are implemented.
- Differences of opinion within the engagement team, or between the engagement team and the engagement quality reviewer or individuals performing activities within the firm's SQM, are brought to the attention of the firm and resolved.

- Engagement documentation is assembled on a timely basis after the date of the engagement report and is appropriately maintained and retained to meet the needs of the firm and comply with law, regulation, relevant ethical requirements, and professional standards.

Resources

The purpose of the resources element is to provide the firm with reasonable assurance that it is appropriately obtaining, developing, using, maintaining, allocating, and assigning resources in a timely manner to enable the design, implementation, and operation of the SOQM.

SQMS No. 1 addresses all resources that the firm needs both to operate the system and to perform engagements, including the following:

- Technological resources. For example, audit tools or IT applications used by the firm for independence monitoring.
- Intellectual resources. For example, the firm's methodology, guidance, templates, or tools.
- Human resources. This may include people outside the firm used in engagements, including component auditors, or engagement quality reviewers who are external to the firm.

The standard focuses on what resources are needed, how they are used and maintained, and whether they are appropriate. The principles-based nature of the requirements relating to resources considers the variety of resources used and their source. The resources section of SQMS No. 1 also covers the use of resources from service providers and how to determine that those resources are appropriate for the intended use by the firm. A resource from a service provider could be a methodology, an IT application, or people used in an engagement. Services that come from a firm's network, if the firm belongs to a network, are not considered as coming from a service provider.

Information and Communication

The purpose of the information and communication element is to address the importance of communicating information obtained, generated, or used both within the firm and to external parties on a timely basis to enable the design, implementation, and operation of the SOQM.

This component of SQMS No. 1 underscores the importance of a continuous flow of information and communication by linking the exchange of information to the firm's culture so that it is driven from top leadership throughout the firm. The standard requires that the firm establish an information system with processes to identify, capture, process, and maintain information, acknowledging that less complex firms with fewer personnel and direct involvement of leadership may accomplish the objective with less rigorous or detailed policies and procedures.

This component also encourages firms to be transparent to external parties about their SOQM in a relevant, innovative, and proactive manner. This component requires that firms establish policies and procedures that address when communications with external parties are appropriate. To promote continual innovation in this area, the standard provides flexibility regarding the specific information communicated, the form of that communication, and the nature, timing, and extent of communication.

The Monitoring and Remediation Process

The purpose of the monitoring and remediation process element is to provide the firm with relevant, reliable, and timely information about the design, implementation, and operation of the SOQM so the firm may take appropriate action to remediate identified deficiencies on a timely basis.

SQMS No. 1 focuses on monitoring activities that address the entire SOQM. The standard emphasizes performing tailored monitoring activities sufficient to provide a basis for the firm to evaluate the SOQM.

The requirements also emphasize factors that firms should consider in designing monitoring activities, rather than prescribing such activities. The nature, timing, and extent of monitoring activities will be driven by many firm-specific factors including the following:

- How the underlying system is designed.
- The nature and circumstances of the firm and engagements it performs.
- The extent of changes to the system.
- The results of previous monitoring activities or external inspections.

This component includes a requirement to inspect completed engagements and for engagement partners to be inspected on a cyclical basis. The firm determines its inspection criteria, including how often to select completed engagements, which completed engagements to select, which engagement partners to select, and how frequently to select an engagement partner. In doing so, the firm considers factors such as other types of monitoring the firm does, areas of risk, and how the system is designed.

The standard includes requirements for evaluating findings, identifying deficiencies, and evaluating the severity and persuasiveness of the deficiencies. These include a requirement to investigate the root cause of identified deficiencies. The requirement is intended to be flexible to encourage firms to scale the nature, timing, and extent of the procedures to investigate the root cause of the deficiencies so that they are appropriate and tailored to the circumstances. The evaluation of the severity and pervasiveness of deficiencies is also used by leadership in evaluating the system and concluding whether it achieved its objectives.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the purpose and process for the newly added “risk assessment” element of a system of quality management.
2. What are the factors that determine the number of risks a firm should identify?
3. Describe the resources a firm needs to operate and perform engagements.

B. Suggested Answers to Discussion Problems

1. The purpose of the risk assessment process element of an SOQM is to establish quality objectives, identify and assess quality risks, and design and implement responses to address the quality risks.

Risk assessment is a three-step process:

- a. Establish quality objectives. The standard requires the firm to establish specific quality objectives for each component except risk assessment and monitoring and remediation. The firm is required to establish additional quality objectives when necessary to achieve the objective of the SOQM. However, the firm may not find it necessary to establish additional quality objectives.
 - b. Identify and assess risks to the achievement of the quality objectives (commonly referred to in the standard as quality risks), which involves:
 - Understanding the factors (e.g., the conditions, events, circumstances, actions, or inactions) that may adversely affect the achievement of the quality objectives and
 - Considering how and the degree to which the factors may adversely affect the achievement of the quality objectives, which does not require formal ratings or scores.
 - c. Design and implement responses to address the quality risks. The nature, timing, and extent of the firm's responses to address the quality risks are based on, and responsive to, the reasons for the assessments given to the quality risks. Certain responses are specified in the standard; however, the specific responses required by the standard will not be sufficient for the firm to address all its quality risks.
2. The number of risks a firm should identify is a matter of professional judgment and depends on the nature and circumstances of the firm.
- If a firm has many risks that are covered by the same responses (for example, policies and procedures), that is a sign that you may be too granular, and you may wish to group the risks.
 - If a firm has not identified risks associated with all responses (for example, policies and procedures), that may be a sign that you haven't identified enough quality risks.

Perform a gap analysis for the quality risks identified by mapping them to current controls (commonly referred to as "responses to quality risks"). Identify quality risks without appropriate responses, as well as any current responses that do not map to a quality risk.

3. SQMS No. 1 addresses all resources that the firm needs both to operate the system and to perform engagements, including the following:
- Technological resources. For example, audit tools or IT applications used by the firm for independence monitoring.
 - Intellectual resources. For example, the firm's methodology, guidance, templates, or tools.
 - Human resources. This may include people outside the firm used in engagements, including component auditors, or engagement quality reviewers who are external to the firm.

The standard focuses on what resources are needed, how they are used and maintained, and whether they are appropriate. The principles-based nature of the requirements relating to resources considers the variety of resources used and their source. The resources section of SQMS No. 1 also covers the use of resources from service providers and how to determine that those resources are appropriate for the intended use by the firm. A resource from a service provider could be a methodology, an IT application, or people used in an engagement. Services that come from a firm's network, if the firm belongs to a network, are not considered as coming from a service provider.

PART 3. SMALL BUSINESS

Ethics Conceptual Framework

All CPAs are subject to the Code of Professional Conduct. From time to time they may find themselves in a situation that requires judgment as it isn't addressed specifically by a rule or interpretation. To help practitioners in making these determinations, the Professional Ethics Executive Committee issued a framework. There are two paths; one for those in public practice and one for those in industry.

For more on the conceptual framework for ethics, let's join Kurt Oestrieher, a CPA and a partner with Oestrieher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk a little bit about the conceptual frameworks, and in particular we're planning to look at the ethical conceptual framework here. To begin with, why don't you give a little bit of a background about that.

Mr. Oestrieher

Like so many other great things, the AICPA Professional Ethics Executive Committee [PEEC] never set out to say, "Oh, we're going to create a framework to help people resolve ethical issues." Now, that is what it has morphed into, but to truly understand how to apply the framework, if you understand how it got here, it's a lot easier to apply it.

The reason it got here was because many, many years ago—now we're talking about 20 to 25 years ago—the AICPA and others began to notice that there were tremendous inconsistencies in the independence interpretations. Meaning you look at a scenario, and they said, "No, according to this interpretation, that impairs independence." You do a few journal entries, and the client doesn't approve it—no, independence is impaired. But then you look over here, and you go, "Yeah, my wife can work for a company, and I can audit it as long as she doesn't have a key financial position." What? That's just one of many examples of the inconsistencies.

Instead of just saying, "Well, let's fix these," the AICPA said, "Well, let's find out why this happened. Let's do a study." Normally that's when I cringe; I'm not big on studies. I'm like, "That's a problem. Just fix it." But this was another example where Kurt was proven wrong because, by instituting that study, they were going to get a better solution, and they found that there were two reasons why these inconsistencies existed.

The first reason is you have to understand that independence rules aren't based on how we think we should act. They're based on how we think the public thinks we should act. In other words, if the public thinks that there's some sort of a conflict or self-interest based on a certain set of facts and scenarios, then we threw the flag on ourselves. So, that is that is the prism through which independence rules were developed.

But remember, public perceptions change over the years. Remember, there was a time when a CPA, if they accepted a commission on a financial product, that was considered mean, dirty, and nasty. All sorts of conflicts. We shouldn't do that, so our ethics prohibited it. That was 20 years ago. They said, "You know what? Y'all are actually well suited to do that." And now we have another company here called Oestrieher Financial Management Services that my father, who was close to retirement age from the traditional CPA [profession], said, "Well, this is something I'd like to do." And now my sister and my father run that company. So, public perceptions change over the years. That's one thing that led to the inconsistencies. When the rules were made, public perception was different in the '40s or '50s versus the '80s or '90s, or 2015. And that makes sense.

[The] second reason they were different is the members of the Professional Ethics Executive Committee who create the interpretations, well, they roll off the committee. So, if you have 20 people looking at a certain set of facts and circumstances, and then you give those exact same set of facts and circumstances to 20 different people, they could

arrive at different conclusions when everything is subjective. That's all independence is. For the most part, these interpretations are subjective thought processes on how we think other people think we should act. So, that was the other problem because people are not going to be able to, when they get into a room to debate these issues, put all their life lessons, personal beliefs, and their ethics aside and say, "Okay, these are the seven important things you need to consider."

The example I always use on this, Debi, is the Supreme Court. Why is it always a bloodbath when a Supreme Court person comes in between the Democrats and the Republicans? Because we know, the way the Constitution was framed, that members of the Supreme Court should only look at the constitutionality of an issue and leave their personal beliefs behind. If that were true, we wouldn't care if it was a Democrat or Republican, a man or a woman, or a certain race or religion. We would just know that our elected leaders would find the best person that understands constitutional law. And that's a fantasy land; you and I know that. So, it proves the humanity of us, which is a good thing. We can't leave behind our personal beliefs—let's call them *biases*, our experiences, whatever—that help us formulate how we perceive a situation.

So, with those two things present, it actually would be considered an unfixable problem because public perceptions will always continue to evolve and change on how CPAs should act on other things in the world. That's why we take polls. Humans are going to change the way they believe, and the people on PEEC would change. So, we would either have to do one of two things at this point. Accept that these inconsistencies will always be present, and now that we know the reason why, at least it's easier to accept them—and that could have been a pathway to go—and then update as necessary.

The other way to go is to say, well, maybe we can smooth out some of these personal biases and the ways we perceive by at least having a steadfast process by which the Committee considers independence issues. So rather than just say, "Hey, I think that impairs independence," or, "I think it doesn't," we're going to come up with a step-by-step process. And that process was (1) we're going to identify threats; (2) then we're going to determine if those threats are [at] an acceptable level; (3) if not, we'll determine if safeguards can reduce them to an acceptable level; [and] (4) then we'll identify those safeguards. That's why, in the non-attest [engagements], you say, "Okay, there [are] some things you absolutely can do and some things you can't do, or some things you absolutely cannot do and some things you can do as long as the client does certain things." Well, those are safeguards.

Ultimately, the Committee called this their *conceptual framework for independence*, and it was only used by the Committee when they were considering interpretations specifically on the independence rules. Remember, PEEC comes up with interpretations on all the ethics rulings. We have rules that are voted on by members, and the interpretations are come up [with] by PEEC. They only reserved this during the portion of the meeting when they were considering independence interpretations, so that was the genesis.

But then someone said, "Wait a second. We mandate that CPAs determine independence in fact and appearance. Well, *factual independence* means they violate one of the interpretations we've come up with. *Independence in appearance* means there's nothing we've ever specifically written about this, but enough questions arise [that] you just have to come to your own conclusion." Then they had that aha moment and said, "This framework that we use to come up with the interpretation is the exact process that members should use, and now we're going to get much more consistency out there within the profession because all of our members are going to be using the same process to determine independence." And it's a good process.

So, they actually then put it in the Code [the AICPA *Code of Professional Conduct*] that when you were making a determination of independence in appearance, you had to use the conceptual framework, but it was only on the independence portion. It didn't apply to integrity, objectivity, acts discreditable, or anything else that was in the Code.

They took that one step further then. I think it was 2014 when they reorganized the ethics code and got rid of sections. We used to have 100, 200, 300, and 500. Now ET [sec.] 1 is if you're a member of public practice, ET [sec.] 2 is business and industry, and ET [sec.] 3 is others, and we put it in this electronic code that you can find on the website.

Now, if you look at any one of those sections in the rules—so, if you go to members in business and industry 2, then 100 (integrity and objectivity) [ET sec. 2.100], you will see after the rule, the next thing it says [is that] a member shall apply the conceptual framework when determining compliance with the integrity and objectivity rule when specific guidance can't be found. I paraphrased there a little bit, but that's everywhere in the Code.

It went from this project helping the committee be more consistent with independence interpretations to being required just for independence interpretations by members of public practice. Now, the conceptual framework should be used by any CPA, regardless of where he or she practices—business and industry, public practice, or other, which is mainly education, when that CPA—we'll call them *members* because this is the AICPA *Code of Professional Conduct*—when that member is faced with what they believe to be a potential ethical issue, yet they cannot find specific guidance either in a rule or the interpretation. Remember, specific guidance will almost always be in an interpretation, because the rules are very broad. As we get into our discussion, Debi, now that you know the background, things can be, “Oh, that's why we do it this way. That's why we do it that way.” So, that background is important.

Ms. Grove Casey

Well, I know that the FASB has a conceptual framework, and actually I think maybe the GASB does as well. Now, those frameworks are typically used by those Boards in issuing their statements. I really have to appreciate that PEEC came out with this—maybe not the requirement portion, but certainly the concept that we should all be considering a conceptual framework if there isn't a specific rule or interpretation for us to follow.

Let's talk about the applicability, though, because you mentioned that we split the guidance a few years ago between members in public practice, those in industry, and others. Could you talk about that a little bit?

Mr. Oestricher

Yes. You never wake up one morning and go, “I'm going to have an ethical dilemma today,” or you hope you don't wake up that way. Unless you're about to cause something that's going to cause it—you have a plan for the day. [The ethical dilemma] drops in our lap. It's the nature of CPAs, I guess; we look at risk. If you do audits or whatever, or you're worried about—if you're in business and industry—things [that] can impact your company, sometimes this little bird lands on our shoulder and says, “Should I do that?” or, “Was I just asked to do something, and if I do it, does that cause a problem for other people?”

It's not like every time I answer the phone and answer a question, I have to go through this mental checklist of, “Am I violating this code? Am I violating this code?” That's not the way humans operate. But we have all had, if you've been in this business as long as I have, moments where clients ask something, third parties ask for something, an attorney gets involved in litigation on something, where you just go, “Dang.” I say something usually more than “dang,” you're right. You know me. But for the public forum, I'm just going to go with “dang.”

So, the first thing we do—and, hopefully, we all know that if you go to the AICPA website, the AICPA *Code of Professional Conduct*, if you search for it, you will find it. It is free. That was part of what they did in 2014. You used to have to buy it, but they said we need transparency because people in public that maybe would [not] buy AICPA materials need to understand how CPAs are behaving or what they're required to do to behave.

So, you go to the *Code of Professional Conduct*, and you look around, and you go, “I just can't find anything, but I think this is maybe an act discreditable.” Or you think it's integrity and objectivity issue. Or I think it is general standards on financial reporting because I was asked to do a journal entry that I think is a little bit squeamish. Or my boss asked me to do something, but I don't think I'm supposed to do that. That's subordination of judgment. So, we look for the different things, and many of those things that I just mentioned—you will find specific guidance on subordination of judgment [and] a failure to follow GAAP [generally accepted accounting principles].

But what if you have one of those things that [isn't covered]? First look in the appropriate place. Section 1—anything that's ET 1.—that's where members in public practice should look. If you're in business and industry, you have your whole different section because you don't have to worry about fees and remuneration, form of organization and name, and independence. You don't have rules like that in section 200, but you still have integrity and objectivity, acts discreditable, and the general standard. So, you've got to make sure you're in the appropriate section.

When you cannot find it, this is when, at least, you go, “Well, I think this is probably integrity and objectivity. If I did this, maybe someone would think I'm not acting with integrity. Therefore, I need to apply the conceptual framework, and I need to know what the integrity and objectivity rule is.” Ultimately, what I'm asking myself is, “If I proceed with this course of action, will I be in violation of the rule?” An interpretation isn't there; I now have a responsibility to come up with my own thought process on how to interpret the rule. So, identify the appropriate rule [and] then start to apply the conceptual framework.

Ms. Grove Casey

Let's talk about those steps in applying the conceptual framework.

Mr. Oestricher

The first thing you do is identify if a threat to non-compliance exists. And we talk about non-compliance—*non-compliance* is compliance with that specific rule. Again, until you've identified a rule, we're kind of out of whack here.

There are seven specific threats that are listed, and you will notice that many of these seem to relate to independence. That's why I gave you a little bit of a history lesson because it started with independence, but it is an *adverse interest threat*. So, that's obviously [related to] independence, but that could also be a conflict of interest if you're in business and industry.

An *advocacy threat*—in other words, should I be out advocating? Well, if you're in business and industry, for the most part, yes, you can do things to advocate for your client, but you can't falsify financial statements or other financial information to advocate for your client or your company. I shouldn't say *client*; it's your *company*.

Familiarity threat. We understand how that happens in independence, but maybe there's no specific policy on nepotism in the organization where I work. But if I'm in charge of hiring, that's a familiarity threat.

Self-interest threat. Again, we see where that would happen in independence, but from a self-interest standpoint, I get to make decisions on using vendors. The new IT provider, every year they invite me to go to the Masters, and they rent out a house, and we go play golf. Well, gee, as long as I switch to them, I'll probably get to keep doing this. It might cost my company a little bit more, but I think their product is better. Well, maybe it is; maybe it isn't. That's self-interest.

Self-review—mainly this is related to independence. But it could be some issue where you have internal controls in business and industry, and it's important for estimates in accounting that there be appropriate controls in place of self-review.

Then, *undue influence threat*. This is where you have conflicts of interest.

So, you identify a threat. If you can't identify a threat, now you have your answer because you go, “You know what? There is no threat. My mind told me that maybe there is an issue, but if I proceed with this, there's no adverse interest. I'm not considered to be an advocate in an inappropriate manner. I'm not hiring anyone or pursuing transactions on the commodity. I don't get any extra money for it. I'm not reviewing my stuff. It's not producing undue influence.” Okay, now I can check a box. None of these threats are something. You move on, and now you can proceed.

But if you identify that some of those threats exist, now you have to start using your judgment. I want to make sure we understand here, with this conceptual framework, you're never trying to eliminate a threat. It's getting the threat to an acceptable level.

There's a great example out there that we can all understand on the difference between acceptable level and elimination. Every single one of us, I hope, can agree—I'm in public practice—that every time I perform an audit, there's a self-interest threat because I'm getting paid. In other words, I will pay for your opinion. That's a self-interest threat. The only way to eliminate that threat is for me to do audits for free, which I'm not going to do. So, the other solution is audits just become like a driver's license. When someone wants you to have an audit, you go to the Louisiana Bureau of Audits, and you stand in line and get your audit.

Now, there is one gentleman in Ohio, when I mentioned this one time, he goes, “Yes, that's what we need to do.” I said, “Really?” He goes, “Yes, that's the only way. You can't be paying for an opinion.” I said, “So, having a governmental agency will solve it?” He goes, “Yes.” I said, “You've never seen governmental agents—people that work for the government—bribed?” “No.” I said, “Move to Louisiana, buddy.” Just because someone's working in the government doesn't mean they can't have the [threat].

So, the solution would be either someone does this for free—because they believe it's in the best interest of the world, and they're willing to work for free, which will never happen—or we just eliminate the audits. Well, third parties need the audit, so we have to find a way to coexist with this threat and reduce it to an acceptable level.

The safeguards that are put in place are peer review, mandatory continuing education, [regulation] by your state board, [and] the actual standards that are developed. Those are the safeguards that are put in place to reduce that threat to an acceptable level. That's what you're trying to do, so whether it is a fee that you're getting from an audit or a conflict of interest—whatever it might be—it is about reducing that threat to an acceptable level. So, we need to understand how that concept works because the next step after you identify a threat is to determine the significance of the threat.

There are three different answers, and only three different answers, you come up with when you're evaluating the significance. Either the threat is significant, and it is so significant that safeguards cannot reasonably reduce it to an acceptable level. If that is your conclusion, stop, do not pass go, do not collect \$200. Go straight to either independence jail, conflict-of-interest jail, or wherever. You can't move forward with it because you now have your answer. Threats there cannot be reduced to an acceptable level.

The other end of the spectrum is, yes, there's a threat, but it's already at an acceptable level. In other words, a reasonable person would say, “It's at an acceptable level. I do not need to add any other safeguards.” Document your reasons and move forward. Those two extremes—occasionally you might come to that conclusion. I think, in most cases, you're going to be in that third option, which is, okay, the threats are not yet at an acceptable level; however, I think there are safeguards that can be put in place that could reduce the threat to an acceptable level. So, I need to identify and determine the effectiveness of those safeguards.... If you get to conclusion three, that's when you start that process.

Ms. Grove Casey

So, to summarize, we need to look at the safeguards and what kinds of things we can do to mitigate those threats that we have. Did you want to talk about that a little bit and the kind of safeguards we can put in place?

Mr. Oestricher

When you look at safeguards, there are what I call internal safeguards and external safeguards. In other words, there [are] *internal safeguards* that you can put in place in your firm. *External safeguards* can be put in place by the client if you're in public practice like me. If you're in business and industry, the external safeguard could be the CPA firm,

a banking relationship, or something like that. You have regulatory safeguards; you have legal safeguards. So, you just identify all those particular areas where safeguards could exist, and then, once you identify what those safeguards could be, you have to say, “Well, are they effective, or can we identify more?”

I can give you a real-life situation that happened ten-plus years ago at our firm. I had a somewhat distant relative (second cousin) win the [election for] Rapides Parish Assessor. After about two years, he came to me he goes, “Kurt, I'm not certain my current auditor is doing their job, and it's very important to me that it ought to be done correctly.” He says, “I want to keep my job. I don't want any surprises. I don't know that he's being thorough enough.” I'm not going to sit there and evaluate what another CPA is doing. That's a little bit unprofessional. And I said, “Besides you're my second cousin, and there would be an independence issue potentially. I just don't want to get into that, so I'll see you, maybe, at Thanksgiving dinner next year.” Sometimes they're there; sometimes they're not. Like, I don't even know, if he said, “Look, come over to the house for a beer,” first of all, I don't drink beer. Secondly, I don't even know where he lives. So, that distant. But still, it's a relative, so I don't want to deal with it. Next year he comes back and says, “Kurt, I need you to do this.” So, I said, “Okay,” and I applied this conceptual framework. I said, “I'm going to go through this, rather than just automatically throwing the penalty flag.”

The more I looked at it, I said, “Maybe there are safeguards.” I called a friend of mine who has served, not once but twice, on the Professional Ethics Executive Committee. He said, “Kurt, I don't think you have a problem. This is not a close family member. It's not a close relative. It's not an immediate family member.” We started talking about some of the safeguards, like within our firm, where my father founded the firm, anyone that's in my family, we would not work on the audit. Other CPAs in the firm would work on the audit. That's an internal safeguard, so think of that. Had we not had this conceptual framework, we never would have called it an internal safeguard.

Then you have to say, “Well, is that effective?” To a certain point, but whoever else is working on it, they know that Mr. O, who runs the firm, that's still a relative of his. This friend of mine said, “Well, look, I will do an external quality control review, and if there are any issues in the audit, then your people can report directly to me.” So, I got another firm involved; that's another external safeguard.

Because this is a governmental audit, it is regulated. Another safeguard we looked at, I contacted the legislative auditor and explained the facts and circumstances, and I'll never forget what he told me. He goes, “Oh, hell, Kurt, in Louisiana everyone's got a second cousin. This isn't a problem.” So, we disclosed it to the regulator. Then, when I wrote up this entire thing with all the safeguards, [my second cousin] said, “Kurt, what the hell is this?” He didn't even know the conceptual framework existed.

Ms. Grove Casey

Existed? Right.

Mr. Oestrieher

And [these were] the days before Zoom and all. He went through, and he goes, “Man, this is awesome.” He goes, “I've never really thought about it this way.” Because, again, a legislative auditor is appointed in our state, but they're not doing audits. They are dealing with the press and all sorts of stuff. So, we became very comfortable, and sure enough, when we got in, let's just say that it is my opinion we're doing this audit much better. The client is happy because, trust me, he told me. He goes, “Kurt, your people—if anybody in my organization is doing something wrong, I want to know. I will never get a job this [good] ever again in my life.” He goes, “I love what I do. It's good benefits, good pay. What I don't want is someone coming in and doing an investigation and finding money stolen. That's the one way to get unelected as an assessor.” I said, “Well, we don't really look for stolen money. We're more worried about if your financials are in accordance with GAAP.” I had to explain that.

I will tell you, had the conceptual framework never been invented, we still would not be doing that audit. That's where it's a good thing. We still have those same safeguards in place today. Now, my father's no longer managing partner

of the firm; I am. But just a classic example. We knew that one safeguard wasn't enough, and the internal safeguards weren't going to be sufficient. So, we found external safeguards, and certainly once the regulator blessed it, then we felt very, very comfortable moving forward.

Again, you have to look at your facts and circumstances, [and] who your external safeguards can be. I will tell you that, even though it's not written anywhere, I am a strong believer, and I think anyone can say this makes common sense: external safeguards are typically going to be more effective than internal safeguards. If it's a close one and you can't find any external safeguards, I think many times you might conclude, "Yes, we looked at all the potential safeguards; however, they were not effective. They did not reduce the risk to an acceptable level." So, that's the process, and you have to work through it and discuss it with people. Once you learn that process, again, it's your friend. It helps you resolve your ethical dilemmas one way or the other because most CPAs understand [it].

I can't think of a single decision, Debi, that I have ever made in my life—whether picking up a client, dismissing a client, doing a job, or not doing a job—that I wouldn't be sitting here talking to you [about] and on this weekend, planning to go to an LSU football game, okay? I mean, anything that would have made it dramatically different, I would have said, "No, don't do that," you know? Oh gee, here's a nice fee of \$7 million for doing something that doesn't seem like it's \$7 million worth of work; you probably shouldn't do it. But [the framework] really helps us document [these decisions] and think through the process. In case you haven't figured it out, I'm a big fan of the conceptual framework.

Ms. Grove Casey

I had, and I noticed that you were not the only one. You mentioned that the legislative auditor was very happy with what you provided, and I'm guessing that was probably documentation. So, maybe we want to talk a little bit about the documentation that we need to be doing—or not even *need* but maybe *should* be doing—when it comes to this conceptual framework and our decisions.

Mr. Oestrieher

Yes and it's not like the auditing standards where they say there's specific documentation that needs to be there. Folks, here's Kurt's recommendation. If you go through this process, trust me, you might need it to defend your actions or to support your reasoning later on [for] a regulatory proceeding, a lawsuit proceeding, a peer review issue, or whatever. So, document the issue. Second thing, I believe, document the applicable rule. You say, "This is the rule that, I think, there's a threat to noncompliance with this rule." Put the rule in there—integrity and objectivity, acts discreditable, whatever. So, (1) facts and circumstances; (2) the rule; (3) then your initial determination (the risk is not at an acceptable level, can't be reduced); [and] (4) document why you believe that. Then you're done, and you don't move forward with whatever it is you want to do. Or document [that the risks] are already at an acceptable level and why.

Someone might disagree with you, but at least if it's your reasonable basis, it's subjective. If you said, "Yes, I remember thinking about that three years ago. When Katie and I talked about it, we thought it was okay." That's not going to win you any friends in court, peer review, [or] regulatory proceedings.

Remember, I mentioned court, regulatory, [and] peer review. First and foremost, the reason we follow standards is because we all accept our licenses from our state boards. When we accept that license every year, we agree to abide by these rules, so we comply first and foremost. It is out of respect for every other CPA out there that I comply with the rules. The day that I don't want to comply with the rules—and some are kind of onerous and they seem ridiculous because I don't get to make all the rules. If I made them all, then they'd obviously make sense, right? But the day I don't want to do that, what do I have to do, Debi? Just turn in my CPA license and call myself an accountant. Call myself a bookkeeper, a tax preparer, [or] a consultant. I am truly honored to be in this profession with all my fellow CPAs, so that is my biggest motivation for following the rules. Secondary is peer review, regulatory, and legal, and they are very real, of course.

Now, [for] your documentation, if you say, “Hey, I need to identify safeguards,” write down those safeguards. If you're in that third option or you're not on either end of the spectrum when you do that initial analysis, then (1) document what safeguards, (2) who's going to apply the safeguards, (3) why you believe they will be effective in reducing the risk to an acceptable level, then (4) you document your conclusion and what you did moving forward. If you have that in an audit file, in a project file, in a personnel file, or wherever that needs to be, and everything that you did was reasonable, then you really shouldn't have any problem with, first of all, your own conscience as to whether or not you followed the standards and [second] a regulatory peer review or legal proceeding. So, documentation is important.

Ms. Grove Casey

Do you have any final thoughts related to this conceptual framework and what practitioners should be doing in their practice?

Mr. Oestrieher

Yes, I just want to emphasize that it's not optional. It is part of the rule. It's not saying, “Hey, this is something you may want to do.” If you have an ethical dilemma—and call those *ethical conflicts*, not *conflicts of interest*, but *ethical conflicts*—you're required to go through this. Once you realize you've stepped into a minefield, apply that framework—it is not optional; apply it—and remember, it is your friend.

You should not use the framework to go, “Hey, I really want to do this audit, so what can I do to try to get there?” You have to approach it from, “I want to comply with standards. I want to maintain my ethical obligations to my fellow CPAs, to everybody involved, so I just want the right answer.” If that is the frame of mind you have as you go through the framework, more often than not, you're going to come to the right conclusion, and then you accept that conclusion.

In the example that I gave you, where I messed up [was] I really started that conceptual framework to document to my second cousin why I couldn't. So, I was actually looking for reasons to say, “Hey, I can't do this audit. I can't do this audit.” I didn't want to do it. And that's when I realized, Kurt, that was the wrong pathway to take. I should have just stopped and applied it logically, logically, logically, and then I can accept the outcome either way. So, it is your friend; use it.

What grade were we in when we learned that [in] a science project you're not supposed to try to find the right formula to get the desired outcome? You're supposed to do the work, and then figure out what the hell happened. I don't know what grade you learned that scientific theory or experiment, but that's what we're supposed to do here.

SUPPLEMENTAL MATERIALS

AICPA Ethics Conceptual Framework

By Kurt Oestrieher, CPA

Introduction

When the Code of Professional Conduct (the Code) was revised in 2014, two new conceptual frameworks were added to address members' compliance with the remainder of the Code. The new Code was effective December 15, 2014, but the conceptual frameworks were subject to a one-year delay, and thus became effective December 15, 2015.

There is still some confusion as to how and when members should use the conceptual frameworks to determine whether they are in compliance with the Code. This course will address the application of the frameworks to both members in public practice and members in business.

Development of the conceptual framework

The Professional Ethics Executive Committee (PEEC) of the AICPA originally developed the conceptual framework in order to develop more consistent interpretations of the independence rule. PEEC later adopted the framework within the Code and required members to apply the framework when determining independence in appearance. Eventually, the concepts of the framework were expanded in order to be flexible enough to provide considerations for all rules in the Code, including those that apply to members in business and industry.

When to apply the conceptual framework

The conceptual frameworks are applied when the member has an issue regarding possible noncompliance with one of the Rules of Conduct and is unable to find an answer in the Rules or Interpretations. The conceptual frameworks cannot be used to override a prohibition against certain actions elsewhere in the Code.

How to apply the conceptual framework

Under the conceptual framework approach, members are required to:

1. Identify threats that could compromise the member's compliance with the rules or be perceived by a reasonable and informed third party who is aware of the relevant information as compromising the member's compliance with the rules,
2. Evaluate the significance of the threat(s) identified,
3. Identify and apply appropriate safeguards, when necessary, and
4. Evaluate whether such safeguards have been effective to eliminate or reduce significant threats to an acceptable level.

Step 1 – Identify Threats

Members may encounter relationships or circumstances that threaten the member's compliance with the rules. The rules and interpretations address many situations, but cannot address all relationships or circumstances that may arise. Thus, when guidance is not provided, the member should evaluate the situation from the perspective of a reasonable and informed third party, using the conceptual framework.

Threats are relationships or circumstances that could impair independence (for members in public practice only) or compromise a member's compliance with the rules (for all members). For members in public practice and members in business, the rules are as follows:

Types of threats to independence:

Adverse interest threat – actions or interests between the member and the client that are in opposition, such as:

- Commencing (or the expressed intention to commence) litigation by either the client or the member against the other
- A client, officer, director or significant shareholder of the client participating in litigation against the firm

Advocacy threat – actions promoting an attest client's interest or position, such as:

- A member provides forensic accounting services or expert witness testimony for a client in litigation
- A firm acts as an investment advisor for an officer, director or 10% shareholder of a client
- A firm underwrites or promotes a client's shares
- A firm acts as a registered agent for a client
- A member endorses a client's products or services
- Representing the client in Tax Court

Familiarity threat – having a close or longstanding relationship with an attest client or knowing individuals or entities (including by reputation) who performed nonattest services for the client, such as:

- A member of the attest engagement team whose immediate family member or close relative is in a key position at the client, such as the chief executive officer
- A partner of the firm who has provided the client with attest services for a prolonged period
- A member who performs insufficient audit procedures when reviewing the results of a nonattest service because the service was performed by the member's firm
- A member of the firm having recently been a director or officer of the client
- A member of the attest engagement team whose close friend is in a key position at the client
- A member has a significant close business relationship with an officer, director or a 10% shareholder of the client

Management participation threat – taking the role of client management or otherwise performing management functions on behalf of an attest client, such as:

- Serving as an officer or director of the client
- Establishing and maintaining internal controls for the client
- Hiring, supervising or terminating employees of the client
- Preparing financial statements for a client

Self-interest threat – potential benefit to a member from a financial interest in, or from some other financial relationship with, an attest client, such as:

- Having a direct financial interest or material indirect financial interest in the client
- Having a loan from the client, from an officer or director of the client, or from an individual who owns 10 percent or more of the client's outstanding equity securities

- The member's spouse enters employment negotiations with the client
- The firm enters into a contingent fee arrangement for a tax refund claim that is not a predetermined fee
- Excessive reliance on revenue from a single attest client
- Having a material joint venture or other material joint business arrangement with the client

Self-review threat – members reviewing as part of an attest engagement evidence that results from their own, or their firm's nonattest work, such as:

- Preparing source documents used to generate the client's financial statements
- A partner in the member's office was associated with the client as an employee, officer, director or contractor
- The member performs bookkeeping services for a client
- The member relies on the work product of the member's firm

Undue influence threat – attempts by an attest client's management or other interest parties to coerce the member or exercise excess influence over the member, such as:

- A threat to replace the member or the member's firm over a disagreement with client management on the application of an accounting principle
- Pressure from the client to reduce necessary audit procedures for the purpose of reducing audit fees
- A gift from the client to the member that is other than clearly insignificant to the member

Types of threats to rules other than independence:

Adverse interest threat – The threat that a member will not act with objectivity because the member's interests are opposed to the interests of the employing organization. Examples of adverse interest threats include the following:

- A member has charged, or expressed an intention to charge, the employing organization with violations of law.
- A member or the member's immediate family or close relative has a financial or another relationship with a vendor, customer, competitor, or potential acquisition of the employing organization.
- A member has sued or expressed an intention to sue the employing organization or its officers, directors, or employees.

Advocacy threat – The threat that a member will promote an employer's interests or position to the point that his or her objectivity is compromised, such as:

- Obtaining favorable financing or additional capital is dependent upon the information that the member includes in, or excludes from, a prospectus, an offering, a business plan, a financing application, or a regulatory filing.
- The member gives or fails to give information that the member knows will unduly influence the conclusions reached by an external service provider or other third party.

Familiarity threat – The threat that, due to a long or close relationship with a person or an employing organization, a member will become too sympathetic to their interests or too accepting of the person's work or employing organization's product or service, such as:

- A member uses an immediate family's or a close relative's company as a supplier to the employing organization.

- A member may accept an individual's work product with little or no review because the individual has been producing an acceptable work product for an extended period of time.
- A member's immediate family or close relative is employed as a member's subordinate.
- A member regularly accepts gifts or entertainment from a vendor or customer of the employing organization.

Self-interest threat – The threat that a member could benefit, financially or otherwise, from an interest in, or relationship with, the employing organization or persons associated with the employing organization, such as:

- A member's immediate family or close relative has a financial interest in the employing organization.
- A member holds a financial interest (for example, shares or share options) in the employing organization, and the value of that financial interest is directly affected by the member's decisions.
- A member is eligible for a profit or other performance-related bonus, and the value of that bonus is directly affected by the member's decisions.

Self-review threat – The threat that a member will not appropriately evaluate the results of a previous judgment made or service performed or supervised by the member, or an individual in the employing organization and that the member will rely on that service in forming a judgment as part of another service, such as:

- When performing an internal audit procedure, an internal auditor accepts work that the auditor previously performed in a different position.
- The member accepts the work previously performed by the member, alone or with others, that will be the basis for providing another professional service.

Undue influence threat – The threat that a member will subordinate the member's judgment to that of an individual associated with the employing organization or any relevant third party due to that individual's position, reputation or expertise, aggressive or dominant personality, or attempts to coerce or exercise excessive influence over the member, such as:

- A member is pressured to become associated with misleading information.
- A member is pressured to deviate from a company policy.
- A member is pressured to change a conclusion regarding an accounting or a tax position.
- A member is pressured to hire an unqualified individual.

Step 2 – Evaluate the significance of the threat

If the member has identified a threat resulting from a relationship or circumstance, the member will need to evaluate the significance of the threat. Members should evaluate identified threats, both individually and in the aggregate, because threats can have a cumulative effect on a member's compliance with the rules. When evaluating the significance of a threat, the member should determine whether the threat is at an acceptable level, that is, would a reasonable and informed third party who is aware of the relationship or circumstance conclude that the threat identified would not compromise the member's compliance with the rules. Additionally, the member should consider both qualitative and quantitative factors, including whether any existing safeguards are in place that already reduce the threat to an acceptable level. If after evaluating the significance of the threat, the member concludes that the threat is at an acceptable level, then the member is not required to evaluate the threat any further and may proceed with the professional service. However, if the member's evaluation of the threat concludes that the threat is not at an acceptable level, then the member must proceed to Step 3.

Step 3 – Identify and apply safeguards

The member may identify safeguards that already exist or may need to identify new safeguards. It is possible that the member will need to apply only one safeguard that may eliminate or reduce multiple threats. However, in some cases, the member may need to apply multiple safeguards to eliminate or reduce one threat to an acceptable level.

Safeguards may be created by the profession, legislation or regulation, or may be implemented by the client or the firm (for members in public practice) or the employing organization (for members in business).

Safeguards created by the profession, legislation, or regulation

- Education and training requirements on ethics and professional responsibilities
- Continuing education requirements on ethics
- Professional standards and the threat of discipline
- Legislation establishing prohibitions and requirements for entities and employees
- Competency and experience requirements for professional licensure
- Professional resources, such as hotlines, for consultation on ethical issues

Safeguards implemented by the client (members in public practice)

- The client has personnel with suitable skill, knowledge and experience who make managerial decisions with respect to the delivery of professional services
- A tone at the top that emphasizes the client's commitment to fair financial reporting and compliance with applicable laws, regulations and corporate governance policies
- Policies and procedures addressing ethical conduct
- A governance structure, such as an active audit committee, designed to ensure appropriate decision making, oversight and communications regarding a firm's services
- Policies that dictate the types of services the entity can hire a firm to provide without causing the firm's independence or objectivity to be considered impaired or that do not serve the public interest

Safeguards implemented by the firm (members in public practice)

- Firm leadership that stresses the importance of complying with the rules and the expectation that engagement teams will act in the public interest
- Policies and procedures designed to implement and monitor engagement quality control
- Documented policies regarding the identification of threats to compliance with the rules, the evaluation of the significance of those threats, and the identification and application of safeguards that can eliminate identified threats or reduce them to an acceptable level
- Internal policies and procedures that are designed to monitor compliance with the firm's policies and procedures
- Policies and procedures that are designed to identify interests or relationships between the firm or its partners and processional staff and the firm's clients

- The use of different partners, partner equivalents and engagement teams from different offices or that report to different supervisors
- Training on, and timely communication of, a firm's policies and procedures and any changes to them for all partners and professional staff
- Policies and procedures designed to monitor the firm's, or a partner's, or a partner equivalent's reliance on revenue from a single client, and that, if necessary, cause action to be taken to address excessive reliance
- Designating someone from senior management as the person responsible for overseeing the functioning of the firm's quality control system
- A means of informing partners and professional staff of attest clients and related entities for whom independence is required
- A disciplinary mechanism that is designed to promote compliance with policies and procedures
- Policies and procedures designed to empower staff to communicate to senior members of the firm any engagement issues that concern them without fear of retribution
- Policies and procedures relating to independence and ethics communications with audit committees or those charged with client governance
- Discussing independence issues with the audit committee or others responsible for the client's governance
- Disclosing to the audit committee or those charged with governance the nature of services that are or will be provided the extent of the fees charged or to be charged for such services
- Involvement of another professional accountant (either inside or outside the firm) who (1) reviews the work that is done for a client or (2) otherwise advises the engagement team
- Consultation on engagement issues with an interested third party, such as a committee of independent directors, a professional regulatory body or another professional accountant
- Rotation of senior personnel who are part of the engagement team
- Policies and procedures designed to ensure that members of the engagement team do not make or assume responsibility for management decisions
- Involvement of another firm to perform part of the engagement
- Involvement of another firm to reperform a nonattest service to the extent necessary to enable it to take responsibility for the service
- Removal of an individual from an engagement team when that individual's financial interests or relationships pose a threat to independence or objectivity
- A consultation function that is staffed with experts in accounting, auditing, independence, ethics, and reporting matters who can help engagement teams (1) assess issues when guidance is unclear or when the issues are highly technical or require a great deal of judgment, and (2) resist undue pressure from a client when the engagement team disagrees with the client about such issues
- Client acceptance and continuance policies that are designed to prevent association with clients who pose an unacceptable threat to the member's compliance with the rules

- Policies that preclude audit partners or partner equivalents from being directly compensated for selling nonattest services to the attest client
- Policies and procedures addressing ethical conduct and compliance with laws and regulations

Safeguards implemented by the employing organization (members in business)

- A tone at the top emphasizing a commitment to fair financial reporting and compliance with applicable laws, rules, regulations, and corporate governance policies
- Policies and procedures addressing ethical conduct and compliance with laws, rules, and regulations
- Audit committee charter, including independent audit committee members
- Internal policies and procedures requiring disclosure of identified interests or relationships among the employing organization, its directors or officers, and vendors, suppliers, or customers
- Internal policies and procedures related to purchasing controls
- Internal policies and procedures related to customer acceptance or credit limits
- Dissemination of corporate ethical compliance policies and procedures, including whistle-blower hotlines, the reporting structure, dispute resolution, or other similar policies, to promote compliance with laws, rules, regulations, and other professional requirements
- Human resource policies and procedures safeguarding against discrimination or harassment, such as those concerning a worker's religion, sexual orientation, gender, or disability
- Human resource policies and procedures stressing the hiring and retention of technically competent employees
- Policies and procedures for implementing and monitoring ethical policies
- Assigning sufficient staff with the necessary competencies to projects and other tasks
- Policies segregating personal assets from company assets
- Staff training on applicable laws, rules, and regulations
- Regular monitoring of internal policies and procedures
- A reporting structure whereby the internal auditor does not report to the financial reporting group
- Policies and procedures that do not allow an internal auditor to monitor areas where the internal auditor has operational or functional responsibilities
- Policies for promotion, rewards, and enforcement of a culture of high ethics and integrity
- Use of third-party resources for consultation as needed on significant matters of professional judgment

After identifying and applying safeguards, the member will need to proceed to Step 4 and use professional judgment to evaluate whether the safeguards to be applied would be effective in eliminating or reducing the threat to an acceptable level.

Step 4 – Evaluate the effectiveness of safeguards

If the member concludes that threats are at an acceptable level after applying the safeguards, then the member may proceed with the professional service. However, if there are no safeguards that can be applied to eliminate the threat or reduce it to an acceptable level, or the member is unable to implement effective safeguards, the circumstance or relationship creating the threat should be changed, or the member should decline or discontinue the professional services or resign from the employing organization. If the member provides professional services under such circumstances, the member will compromise compliance with the rules.

Step 5 – Document threats and safeguards (recommended)

When safeguards are applied to eliminate or reduce significant threats to an acceptable level, the member is encouraged to document the identified threats and safeguards applied. The documentation should include detail related to the specific rule where threats exist, the threats, the evaluation of the threats, and the evaluation of safeguards. The final conclusion should also be documented.

Summary

The Conceptual Framework is not only helpful in allowing a member to evaluate compliance with the AICPA Code of Professional Conduct when faced with potential ethics violations, it is required. Any CPA that is bound by the Code should be familiar with the Conceptual Framework, when to apply it and how to apply it. Documentation of all considerations, and use of terminology that is consistent with the requirements of the Framework, is essential in order to establish compliance by the member.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss why the Conceptual Framework was developed and when it should be applied.
2. Discuss how to apply the Conceptual Framework.
3. Discuss what is meant by threats to independence and how using the Conceptual Framework helps.

B. Suggested Answers to Discussion Problems

1. The Professional Ethics Executive Committee (PEEC) of the AICPA originally developed the conceptual framework in order to develop more consistent interpretations of the independence rule. PEEC later adopted the framework within the Code and required members to apply the framework when determining independence in appearance. Eventually, the concepts of the framework were expanded in order to be flexible enough to provide considerations for all rules in the Code, including those that apply to members in business and industry.

The conceptual frameworks are applied when the member has an issue regarding possible noncompliance with one of the Rules of Conduct and is unable to find an answer in the Rules or Interpretations. The conceptual frameworks cannot be used to override a prohibition against certain actions elsewhere in the Code.

2. Under the conceptual framework approach, members are required to:
 - Identify threats that could compromise the member's compliance with the rules or be perceived by a reasonable and informed third party who is aware of the relevant information as compromising the member's compliance with the rules,
 - Evaluate the significance of the threat(s) identified,
 - Identify and apply appropriate safeguards, when necessary, and
 - Evaluate whether such safeguards have been effective to eliminate or reduce significant threats to an acceptable level.
3. Members may encounter relationships or circumstances that threaten the member's compliance with the rules. The rules and interpretations address many situations, but cannot address all relationships or circumstances that may arise. Thus, when guidance is not provided, the member should evaluate the situation from the perspective of a reasonable and informed third party, using the conceptual framework. Threats are relationships or circumstances that could impair independence (for members in public practice only) or compromise a member's compliance with the rules (for all members).

GLOSSARY OF KEY TERMS

COSO—Committee of Sponsoring Organizations of the Treadway Commission

Endowments—money set aside (invested) to earn revenue to fund some type of charitable activity;

External Safeguards—safeguards outside the entity facing where the threat exists; could be the accounting firm; a banking relationship, regulators, legal safeguards;

Independence in Appearance—no rule specifically against a behavior, but an outside third party may question if the professional's behavior is ethical

Independence in Fact—no violation of a specific rule or interpretation in the AICPA Code of Professional Conduct

Internal Safeguards—safeguards to threats put in place within the accounting firm

Net Assets—nonprofits have net assets vs equity; the wealth of the nonprofit over time

NGOs—Nonprofit Governmental Organizations

PEEC—Professional Ethics Executive Committee

PGA—Professional Golf Association

Quality Risks—a risk that has a reasonable possibility of occurring, and individually, or in combination with other risks, adversely affecting the achievement of one or more quality objectives

SQMS—Statement on Quality Management Standards

Underwater Endowments—when the fair value of the fund at the reporting date is less than either: The amount of the original gift. The amount required to be maintained by the donor or by law

Choose the best response and record your answer in the space provided on the answer sheet.

1. According to Kurt Oestrieher, all of the following are members of the Financial Accounting Foundation (FAF) **except** for which of the following?
 - A. Financial Accounting Standards Board (FASB).
 - B. Governmental Accounting Standards Board (GASB).
 - C. Nonprofit Accounting Standards Board (NASB).
 - D. Federal Accounting Standards Advisory Board (FASAB).

2. According to Kurt Oestrieher, an organization cannot be considered a nonprofit until what occurs?
 - A. It receives a grant from the government.
 - B. It is run like a business.
 - C. It raises a certain amount for charity.
 - D. The IRS says it is a nonprofit.

3. According to Kurt Oestrieher, a nonprofit organization's statement of financial position is equivalent to what financial statement typically used by a for-profit business?
 - A. Balance sheet.
 - B. Statement of activities.
 - C. Statement of cash flows.
 - D. Statement of income.

4. According to Kurt Oestrieher, why is the statement of functional expenses important to donors?
 - A. It shows changes in net assets instead of net income.
 - B. It shows them where the money is going.
 - C. It allows expenses and revenues to be aggregated.
 - D. It illustrates the mission of the nonprofit organization.

5. According to Kurt Oestrieher, with few exceptions, the amount of an endowment is generally classified as part of what?
 - A. Net assets with donor restrictions.
 - B. Net assets without donor restrictions.
 - C. Expenses or expenditures.
 - D. Investment, equity, or debt securities.

Continued on next page

6. According to Jennifer Louis, why did the AICPA update the quality management standards?
 - A. So firms can tailor their system of quality management to specific engagement types rather than the nature and circumstances of the firm as a whole.
 - B. To encourage firms to use a more risk-based approach when designing, implementing, and operating their system of quality management.
 - C. To create systems of quality management that are more uniform in nature rather than being customized by individual firms.
 - D. So that firms will place new quality management policies and procedures into operation by the end of 2024.
7. According to Jennifer Louis, what are *quality risks*?
 - A. Risks that a firm faces in relation to its sense of governance and leadership.
 - B. Risks that a firm encounters when accepting and continuing clients or engagements.
 - C. Risks that could keep a firm from reaching its specific quality objectives.
 - D. All of the risks faced by a firm that has a quality management system.
8. According to Jennifer Louis, which of the following actions will help a firm manage its quality risks?
 - A. Designate a firm member as the go-to person to provide guidance on independence issues and other ethical requirements.
 - B. Keep differences of opinion within specific engagement teams so as not to disturb the rest of the firm.
 - C. Rely on word of mouth rather than an organizational chart when structuring the firm's personnel.
 - D. Avoid breaking quality objectives into sub-objectives unless the firm has remote workers or those that are otherwise geographically dispersed.
9. According to Jennifer Louis, how does compliance with the new quality management standards relate to compliance with the previous quality control standards?
 - A. If firms already have a system of quality control in place, few changes should be needed to conform it to the new requirements.
 - B. Firms should know what response is necessary prior to evaluating their quality risks to better adjust their existing system.
 - C. Firms need to rebuild their quality management system from the ground up, but they can use information gleaned from their old quality control system.
 - D. Due to the nature of the new risk-based process in the quality management systems, firms cannot use anything related to a prior quality control system.
10. According to Jennifer Louis, how detailed should a firm's documentation of the risk-assessment process be under the new quality management standards?
 - A. Firms must document every risk they consider as part of the risk-assessment process.
 - B. Firms must document a minimum number of risks outlined in the standards when going through the risk-assessment process.
 - C. Firms must document enough risks while going through the risk-assessment process to determine which are actually quality risks.
 - D. As long as the final objectives and procedures are documented, the risk-assessment process itself does not need to be documented.

Continued on next page

11. According to Kurt Oestrieher, what is a *factual independence* issue?
- A. An issue that may violate an interpretation set by the Professional Ethics Executive Committee (PEEC).
 - B. A question that arises that requires professional judgment because it is not covered by a PEEC interpretation.
 - C. An issue that cannot be solved using the conceptual framework used by the PEEC to come up with their interpretations.
 - D. An issue related to acts discreditable that is outlined in the AICPA *Code of Professional Conduct* (the Code).
12. According to Kurt Oestrieher, where is the first place that members in public practice should look when an ethical dilemma arises that is not covered by a PEEC interpretation?
- A. ET sec. 1.
 - B. ET sec. 2.
 - C. ET sec. 3.
 - D. All sections of the Code apply equally to all CPAs.
13. According to Kurt Oestrieher, conflicts of interest fall under which of the following?
- A. The advocacy threat.
 - B. The self-interest threat.
 - C. The self-review threat.
 - D. The undue interest threat.
14. According to Kurt Oestrieher, what type of safeguards are most effective at reducing threats to an acceptable level?
- A. Internal safeguards.
 - B. External safeguards.
 - C. It depends on the individual facts and circumstances of the engagement.
 - D. All safeguards are equally effective, so it is important to use as many as possible.
15. According to Kurt Oestrieher, the PEEC's conceptual framework is which of the following?
- A. Too complicated.
 - B. A minefield.
 - C. Your friend.
 - D. Your enemy.

Subscriber Survey

Evaluation Form

Please take a few minutes to complete this survey related to **CPE Network® A&A Report** and return with your quizzer or group attendance sheet to CeriFi, LLC. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to CPLgrading@cerifi.com.

How would you rate the topics covered in the February 2024 **CPE Network® A&A Report**? Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Not for Profit Financial Reporting	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Implementing Quality Management Standards	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Ethics Conceptual Framework	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Which segments of the February 2024 issue of **CPE Network® A&A Report** did you like the most, and why?

Which segments of the February 2024 issue of **CPE Network® A&A Report** did you like the least, and why?

What would you like to see included or changed in future issues of **CPE Network® A&A Report**?

How would you rate the effectiveness of the speakers in the February 2024 **CPE Network® A&A Report**? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Jennifer Louis			
Kurt Oestrieher			

Are you using **CPE Network® A&A Report** for: CPE Credit ☐ Information ☐ Both ☐

Were the stated learning objectives met? Yes ☐ No ☐ _____

If applicable, were prerequisite requirements appropriate? Yes ☐ No ☐ _____

Were program materials accurate? Yes ☐ No ☐ _____

Were program materials relevant and contribute to the achievement of the learning objectives? Yes ☐ No ☐

Were the time allocations for the program appropriate? Yes ☐ No ☐ _____

Were the supplemental reading materials satisfactory? Yes ☐ No ☐ _____

Were the discussion questions and answers satisfactory? Yes ☐ No ☐ _____

Specific Comments: _____

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Once Again, Thank You...

Your Input Can Have a Direct Influence on Future Issues!

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I certify that the above individuals viewed and were participants in the group discussion with this issue/segment of the CPE Network® newsletter, and earned the number of hours shown.

Instructor Name: _____

Date: _____

E-mail address:

License State and Number:

CPE Network/Webinar Delivery Tracking Report

Course Title	
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Start Time:	
End Time:	
Moderator Name, Credentials, and Signature Attestation of Attendance:	
Delivery Method:	Group Internet Based
Total CPE Credit:	3.0
Instructions:	During the webinar, the moderator must verify student presence a minimum of <u>3 times per CPE hour</u> . This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

[illegible]

CHECKPOINT LEARNING NETWORK

CPE NETWORK[®]

USER GUIDE

REVISED December 31, 2023

Welcome to CPE Network!

CPE Network programs enable you to deliver training programs to those in your firm in a manageable way. You can choose how you want to deliver the training in a way that suits your firm's needs: in the classroom, virtual, or self-study. You must review and understand the requirements of each of these delivery methods before conducting your training to ensure you meet (and document) all the requirements.

This User Guide has the following sections:

- **“Group Live” Format:** The instructor and all the participants are gathered into a common area, such as a conference room or training room at a location of your choice.
- **“Group Internet Based” Format:** Deliver your training over the internet via Zoom, Teams, Webex, or other application that allows the instructor to present materials that all the participants can view at the same time.
- **“Self-Study” Format:** Each participant can take the self-study version of the CPE Network program on their own computers at a time and place of their convenience. No instructor is required for self-study.
- **Transitioning From DVDs:** For groups playing the video from the online platform, we suggest downloading the video from the Checkpoint Learning player to the desktop before projecting.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

IMPORTANT: If you vary from the instructions noted above, your firm will become the sponsor of the training event and you will have to create your own certificates of completions for your participants. In this case, you do not need to submit any documentation back to CeriFi, LLC.

If you have any questions on this documentation or requirements, refer to the “Getting Help” section at the end of this User Guide **BEFORE** you conduct your training.

**We are happy that you chose CPE Network for your training solutions.
Thank you for your business and HAPPY LEARNING!**

Copyrighted Materials

CPE Network program materials are copyrighted and may not be reproduced in another document or manuscript in any form without the permission of the publisher. As a subscriber of the **CPE Network Series**, you may reproduce the necessary number of participant manuals needed to conduct your group study session.

“Group Live” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template after the executive summary of the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance

You must monitor individual participant attendance at “group live” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **attendance sheet**. This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they attended should be documented on the sign-in sheet and will be reflected on the participant’s CPE certificate.

Real Time Instructor During Program Presentation

“Group live” programs must have a **qualified, real time instructor while the program is being presented**. Program participants must be able to interact with the instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A “group live” program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Make-Up Sessions

Individuals who are unable to attend the group study session may use the program materials for self-study online.

- If the emailed materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his/their CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by Checkpoint Learning Network after the “group live” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the “group live” session, it is required that the firm hosting the “group live” session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Group Study Attendance sheets; indicating any late arrivals and/or early departures)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations.

Finding the Transcript

Note: DVDs no longer ship with this product effective 3/1/2023.

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- <https://get.adobe.com/reader/>

The entire transcript is also available as a pdf in the Checkpoint Learning player in the resource toolbox at the top of the screen, or via the link in the email sent to administrators.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group live” session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@cerifi.com

When sending your package to CeriFi, you must include ALL of the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Attendance Sheet		Use this form to track attendance during your training session.
Subscriber Survey Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

All CPE Network products are developed and intended to be delivered as 3 CPE credits. You should allocate sufficient time in your delivery so that there is no less than 2.5 clock hours:

50 minutes per CPE credit TIMES 3 credits = 150 minutes = 2.5 clock hours

If you wish to have a break during your training session, you should increase the length of the training beyond 2.5 hours as necessary. For example, you may wish to schedule your training from 9 AM to 12 PM and provide a ½ hour break from 10:15 to 10:45.

***Effective November 1, 2018:** Checkpoint Learning CPE Network products ‘group live’ sessions must be delivered as 3 CPE credits and accredited to the field(s) of study as designated by Checkpoint Learning Network. Checkpoint Learning Network will not issue certificates for “group live” deliveries of less than 3 CPE credits (unless the course was delivered as 3 credits and there are partial credit exceptions (such as late arrivals and early departures). Therefore, if you decide to deliver the “group live” session with less than 3 CPE credits, your firm will be the sponsor as Checkpoint Learning Network will not issue certificates to your participants.

Advertising / Promotional Page

Create a promotion page (use the template following the executive summary in the transcript). You should circulate (e.g., email) to potential participants prior to training day. You will need to submit a copy of this page when you request certificates.

Monitoring Attendance in a Webinar

You must monitor individual participant attendance at “group internet based” programs to assign the correct number of CPE credits. A participant’s self-certification of attendance alone is not sufficient.

Use the **Webinar Delivery Tracking Report**. This form lists the moderator(s) name and credentials, as well as the first and last name of each participant attending the seminar. During a webinar you must set up a monitoring mechanism (or polling mechanism) to periodically check the participants’ engagement throughout the delivery of the program. Participants’ two-way video should remain on during the entire presentation.

In order for CPE credit to be granted, you must confirm the presence of each participant **3 times per CPE hour and the participant must reply to the polling question**. Participants that respond to less than 3 polling questions in a CPE hour will not be granted CPE credit. For example, if a participant only replies to 2 of the 3 polling questions in the first CPE hour, credit for the first CPE hour will not be granted. (Refer to the Webinar Delivery Tracking Report for examples.)

Examples of polling questions:

1. You are using **Zoom** for your webinar. The moderator pauses approximately every 15 minutes and asks that participants confirm their attendance by using the “raise hands”

feature. Once the participants raise their hands, the moderator records the participants who have their hands up in the **webinar delivery tracking report** by putting a YES in the webinar delivery tracking report. After documenting in the spreadsheet, the instructor (or moderator) drops everyone's hands and continues the training.

2. You are using **Teams** for your webinar. The moderator will pause approximately every 15 minutes and ask that participants confirm their attendance by typing "Present" into the Teams chat box. The moderator records the participants who have entered "Present" into the chat box into the **webinar delivery tracking report**. After documenting in the spreadsheet, the instructor (or moderator) continues the training.
3. If you are using an application that has a way to automatically send out polling questions to the participants, you can use that application/mechanism. However, following the event, you should create a **webinar delivery tracking report** from your app's report.

Additional Notes on Monitoring Mechanisms:

1. The monitoring mechanism does not have to be "content specific." Rather, the intention is to ensure that the remote participants are present and paying attention to the training.
2. You should only give a minute or so for each participant to reply to the prompt. If, after a minute, a participant does not reply to the prompt, you should put a NO in the webinar delivery tracking report.
3. While this process may seem unwieldy at first, it is a required element that sponsors must adhere to. And after some practice, it should not cause any significant disruption to the training session.
4. **You must include the Webinar Delivery Tracking report with your course submission if you are requesting certificates of completion for a "group internet based" delivery format.**

Real Time Moderator During Program Presentation

"Group internet based" programs must have a **qualified, real time moderator while the program is being presented**. Program participants must be able to interact with the moderator while the course is in progress (including the opportunity to ask questions and receive answers during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

Where individual participants log into a group live program they are required to enable two-way video to participate in a virtual face-to-face setting (with cameras on), elements of engagement are required (such as group discussion, polling questions, instructor posed questions with time for reflection, or a case study with engagement throughout the presentation) in order to award CPE credits to the participants. Participation in the two-way video conference must be monitored and documented by the instructor or attendance monitor in order to authenticate attendance for program duration. The participant-to-attendance

monitor ratio must not exceed 25:1, unless there is a dedicated attendance monitor in which case the participant-to-attendance monitor ratio must not exceed 100:1.

Make-Up Sessions

Individuals who are unable to attend the “group internet based” session may use the program materials for self-study either in print or online.

- If emailed materials are used, the user should read the materials, watch the video, and answer the quizzer questions on the CPE Quizzer Answer Sheet. Send the answer sheet and course evaluation to the email address listed on the answer sheet and the CPE certificate will be mailed or emailed to the user. Detailed instructions are provided on Network Program Self-Study Options.
- If the online materials are used, the user should log on to her/his individual Checkpoint Learning account to read the materials, watch the interviews, and answer the quizzer questions. The user will be able to print her/his CPE certificate upon completion of the quizzer. (If you need help setting up individual user accounts, please contact your firm administrator or customer service.)

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded by Checkpoint Learning Network after the “group internet based” documentation is received (and providing the course is delivered as 3 CPE credits). The certificate of completion will reflect the credit hours earned by the individual, with special calculation of credits for those who may not have answered the required amount of polling questions.

Subscriber Survey Evaluation Forms

Use the evaluation form. You must include a means for evaluating quality. At the conclusion of the “group live” session, evaluations should be distributed and any that are completed are collected from participants. Those evaluations that are completed by participants should be returned to Checkpoint Learning Network along with the other course materials. While it is required that you circulate the evaluation form to all participants, it is NOT required that the participants fill it out. A preprinted evaluation form is included in the transcript each month for your convenience.

Retention of Records

Regardless of whether Checkpoint Learning Network is the sponsor for the “group internet based” session, it is required that the firm hosting the session retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (Webinar Delivery Tracking Report)
- Copy of the program materials
- Timed agenda with topics covered
- Date and location (which would be “virtual”) of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name and credentials
- Results of program evaluations

Finding the Transcript

Note: DVDs are no longer shipped effective 3/1/2023

When the DVD is inserted into a DVD drive, the video will immediately begin to play and the menu screen will pop up, taking the entire screen. Hitting the Esc key should minimize it to a smaller window. To locate the pdf file of the transcript either to save or email to others, go to the start button on the computer. In My Computer, open the drive with the DVD. It should look something like the screenshot below. The Adobe Acrobat files are the transcript files. If you do not currently have Adobe Acrobat Reader (Mac versions of the reader are also available), a free version of the reader may be downloaded at:

- <https://get.adobe.com/reader/>

Alternatively, for those without a DVD drive, the email sent to administrators each month has a link to the pdf for the newsletter. The email may be forwarded to participants who may download the materials or print them as needed.

Requesting Participant CPE Certificates

When delivered as 3 CPE credits, documentation of your “group internet based” session should be sent to Checkpoint Learning Network by the following means:

Email: CPLgrading@CeriFi.com

When sending your package to CeriFi, you must include ALL the following items:

Form Name	Included?	Notes
Advertising / Promotional Page		Complete this form and circulate to your audience before the training event.
Webinar Delivery Tracking Report		Use this form to track the attendance (i.e., polling questions) during your training webinar.
Evaluation Form		Circulate the evaluation form at the end of your training session so that participants can review and comment on the training. Return to CeriFi any evaluations that were completed. You do not have to return an evaluation for every participant.

Incomplete submissions will be returned to you.

“Self-Study” Format

If you are unable to attend the live group study session, we offer two options for you to complete your Network Report program.

Self-Study—Email

Follow these simple steps to use the printed transcript and video:

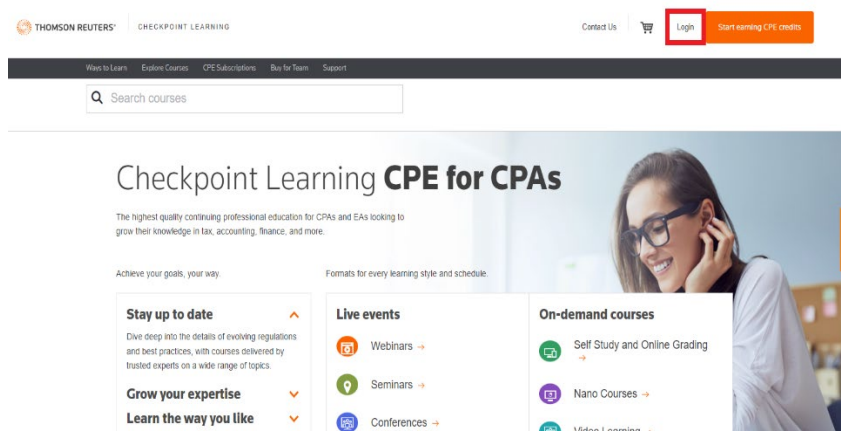
- Watch the video.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
- E-mail your completed quizzer and survey to:

CPLgrading@cerifi.com

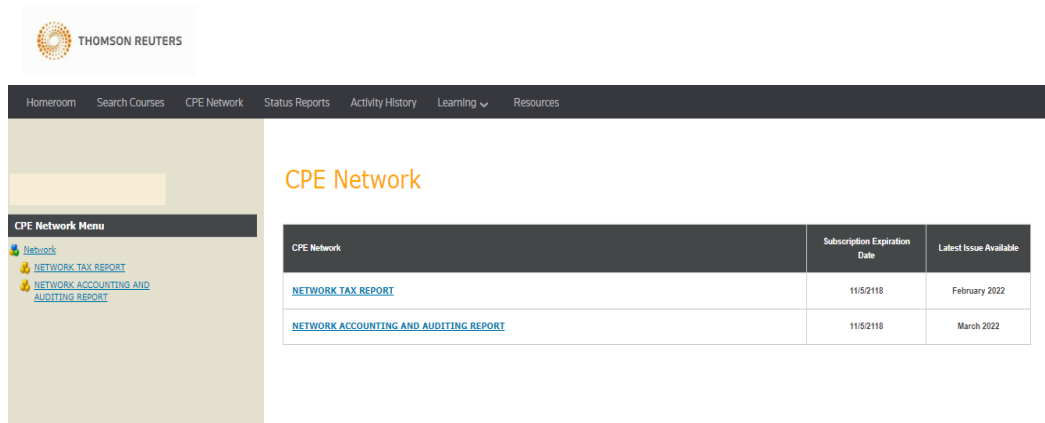
Self-Study—Online

Follow these simple steps to use the online program:

- Go to www.checkpointlearning.thomsonreuters.com.
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).

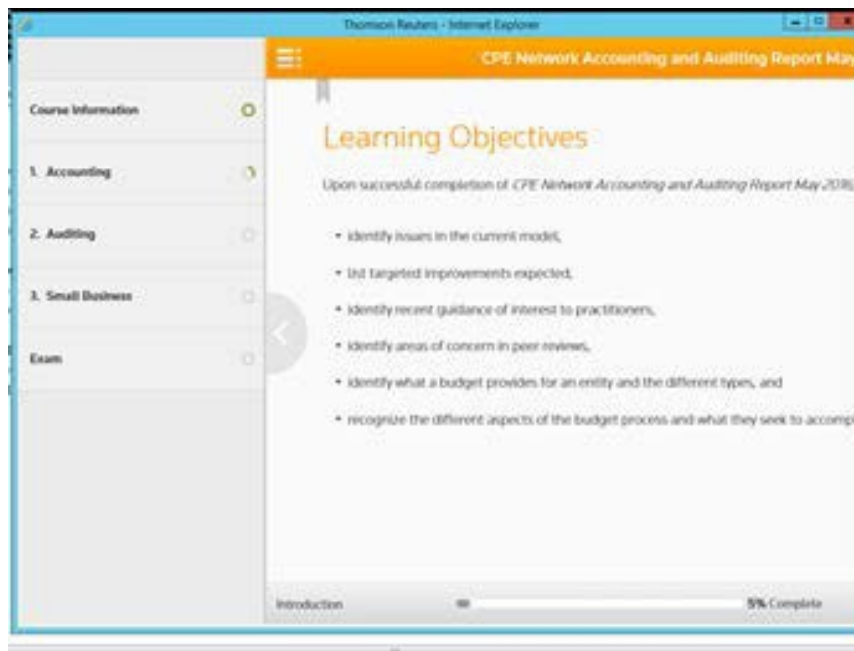


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



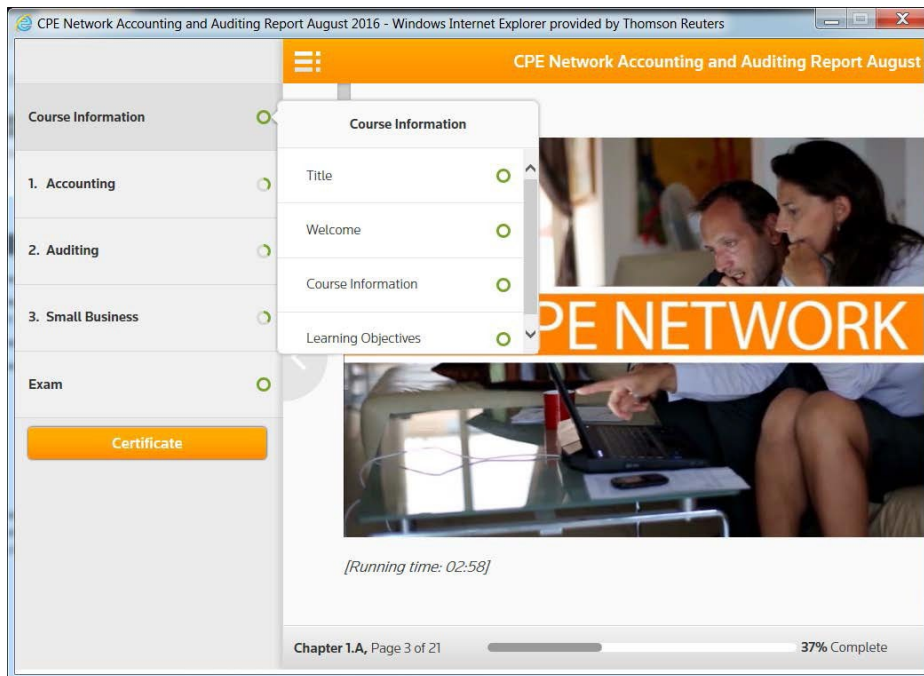
CPE Network	Subscription Expiration Date	Latest Issue Available
NETWORK TAX REPORT	11/5/2118	February 2022
NETWORK ACCOUNTING AND AUDITING REPORT	11/5/2118	March 2022

The Chapter Menu is in the gray bar at the left of your screen:

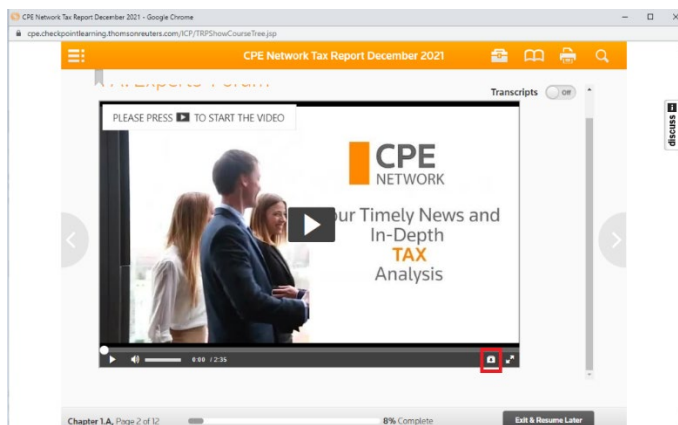


Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives



- **Each Chapter is self-contained.** Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This streamlined approach allows administrators and users to more easily access the related materials.



Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.

Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2016

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

Please note that the transcript [Liabilities and Equity Transcripts](#) can also be found as a link and in the Tools section.

Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

Transcripts for the interview segments can be viewed at the right side of the screen via a toggle button at the top labeled **Transcripts** or via the link to the pdf below the video (also available in the toolbox in the resources section). The pdf will appear in a separate pop-up window.

D:\xml\production\working\U6015494\N... Network Accounting and Auditing Report May 2016

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

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Please note that the transcript [Liabilities and Equity Transcripts](#) can also be found as a link and in the Tools section.

Chapter 1A, Page 4 of 21 8% Complete [Exit & Resume Later](#)

CHAPTER 1: ACCOUNTING

Liabilities and Equity: Another Look at the Model

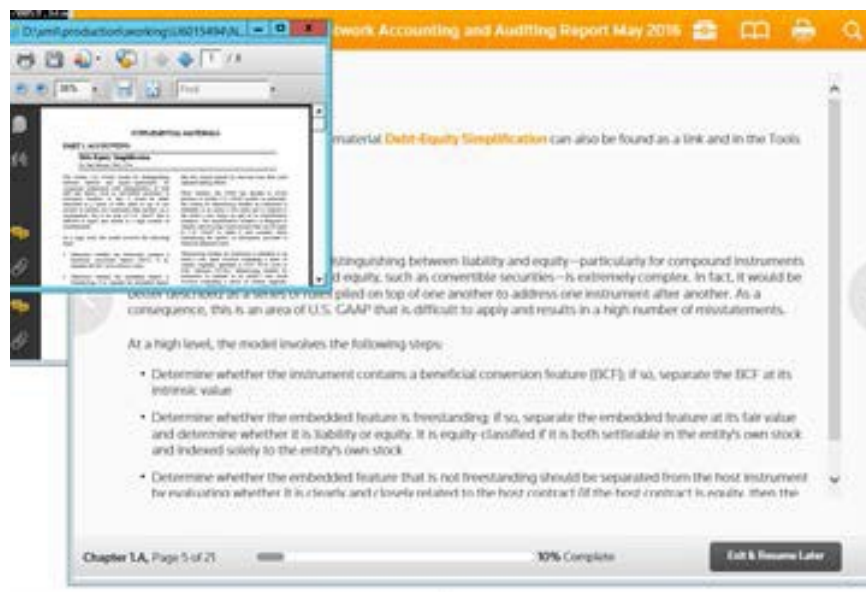
Both the FASB and the AICPA have targeted improvements to the guidance related to liabilities and equity instruments. The current debt-equity model in U.S. GAAP is very complex, making it difficult for both preparers and accountants to implement.

For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



Continuing to click the arrow to the right side of the screen will bring the user to the Discussion problems related to the segment.

The Suggested Answers to the Discussion Problems follow the Discussion Problems.

The screenshot displays a web-based interface for a CPE (Continuing Professional Education) report. The header bar is orange and contains the text "CPE Network Accounting and Auditing Report July 2016" along with icons for a home page, a book, a printer, and a search function. Below the header, the main content area is titled "Suggested Answers to Discussion Problems". It contains three numbered items related to ASC 320. Item 1 lists three categories of securities: Held-to-maturity, Trading, and Available-for-sale, followed by a paragraph explaining that classification is based on the intended holding period. Item 2 describes the trading securities category. Item 3 discusses impairment recognition. The interface includes a vertical scrollbar on the right and a footer bar at the bottom showing "Chapter 3.A, Page 20 of 20", a progress indicator at "100% Complete", and an "Exit & Resume Later" button.

Suggested Answers to Discussion Problems

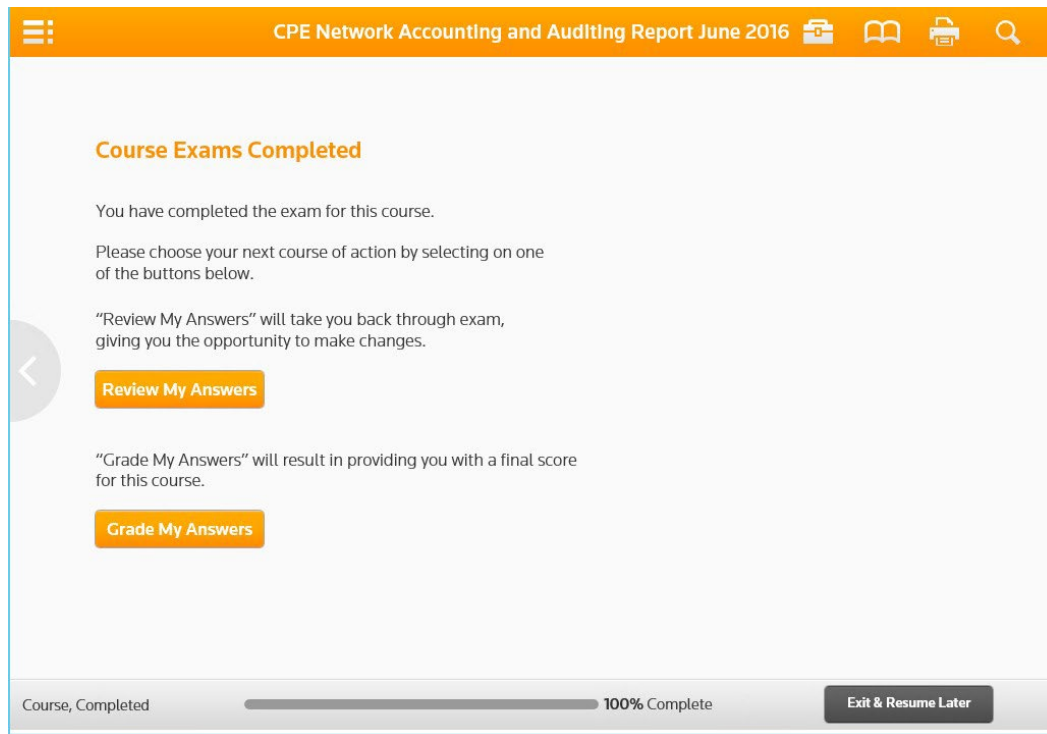
1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories:
 - Held-to-maturity
 - Trading
 - Available-for-sale

An entity decides how to classify securities based on its intended holding period for each individual security, using the framework in ASC 320. In establishing its intent, an entity should consider relevant trends and experience, such as previous sales and transfers of securities. Classification decisions should be made at acquisition and, preferably, formally documented. It is not appropriate to use "hindsight" to classify securities transactions, perhaps by considering changes in value after acquisition.
2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price. "Short-term," in this context, is intended to be measured in hours and days, rather than in months or years, according to ASC 320. However, an entity is not precluded from classifying as trading a security it plans to hold for a longer period, as long as that designation occurs at acquisition.
3. Impairment is recognized in earnings when a decline in value has occurred that is deemed to be other than temporary, and the current fair value becomes the new cost basis for the security. An investment is considered to be impaired if the fair value of the investment is less than its cost basis. Cost includes adjustments made for

Chapter 3.A, Page 20 of 20 100% Complete [Exit & Resume Later](#)

The **Exam** is accessed by clicking the last gray bar on the menu at the left of the screen or clicking through to it. Click the orange button to begin.

When you have completed the quizzer, click the button labeled **Grade or the Review button**.



- Click the button labeled **Certificate** to print your CPE certificate.
- The final quizzer grade is displayed and you may view the graded answers by clicking the button labeled **view graded answer**.

Additional Features Search

Checkpoint Learning offers powerful search options. Click the **magnifying glass** at the upper right of the screen to begin your search. Enter your choice in the **Search For:** box.

Search Results are displayed with the number of hits.

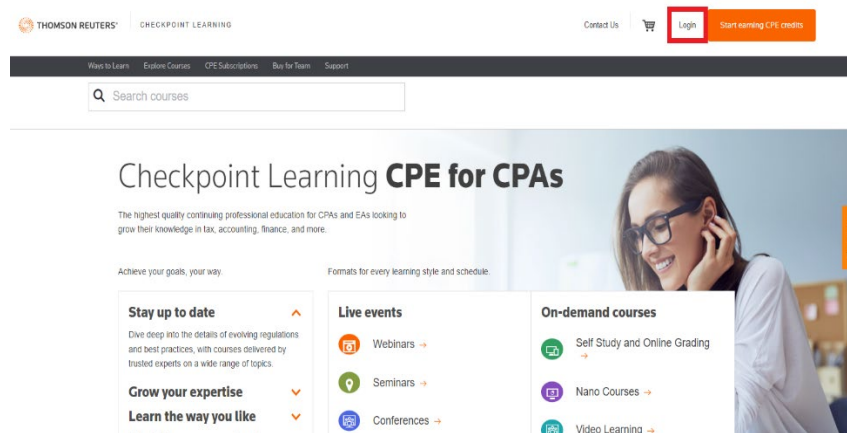
Print

To display the print menu, click the printer icon in the upper bar of your screen. You can print the entire course, the transcript, the glossary, all resources, or selected portions of the course. Click your choice and click the orange **Print**.

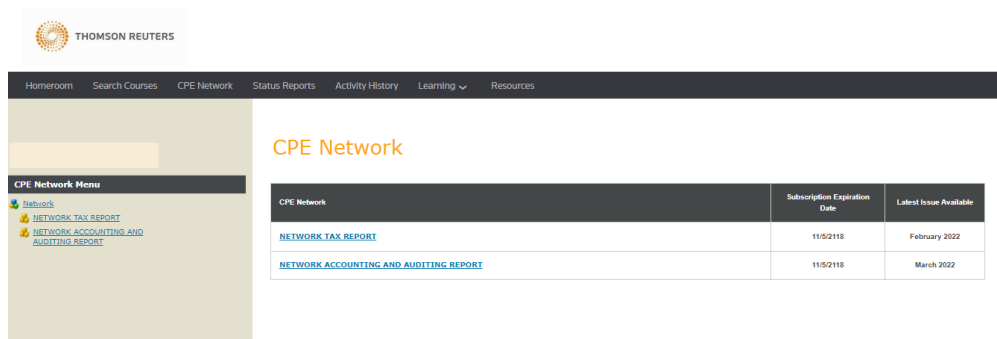
Transitioning From DVDs

Follow these simple steps to access the video and pdf for download from the online platform:

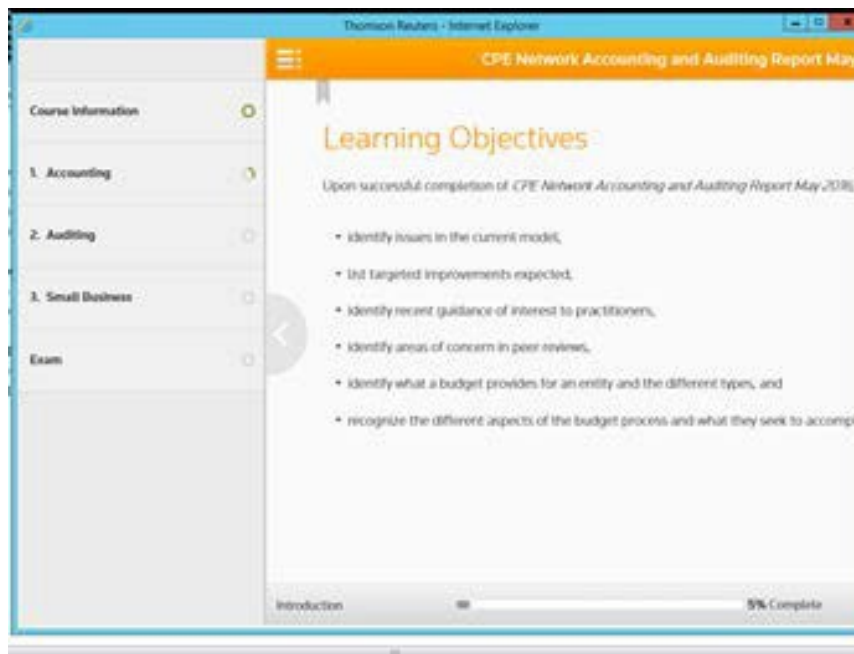
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



- In the CPE **Network** tab, select the desired Network Report by clicking on the title, then select the appropriate edition.

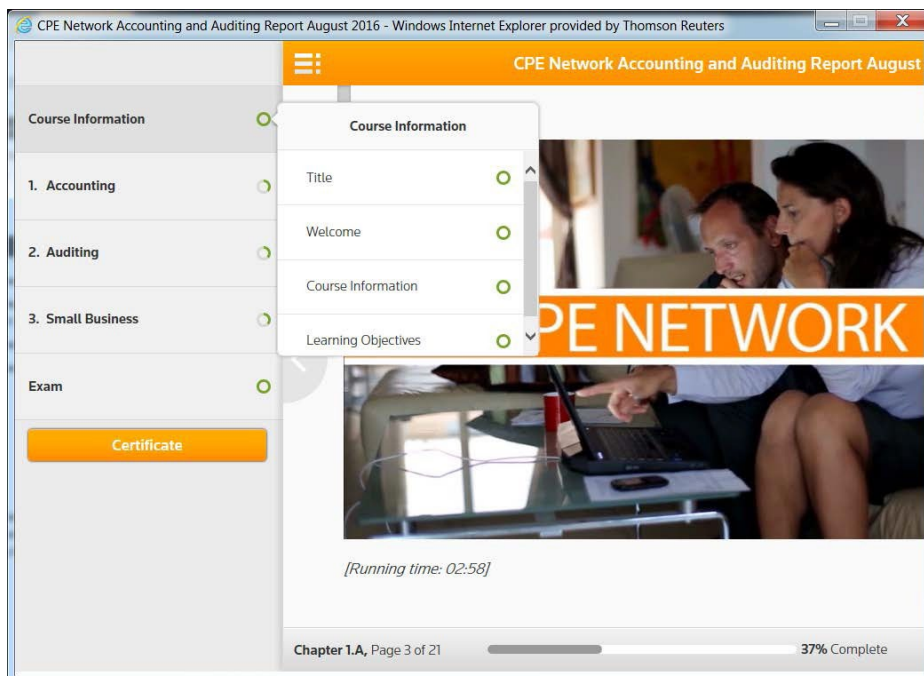


The Chapter Menu is in the gray bar at the left of your screen:

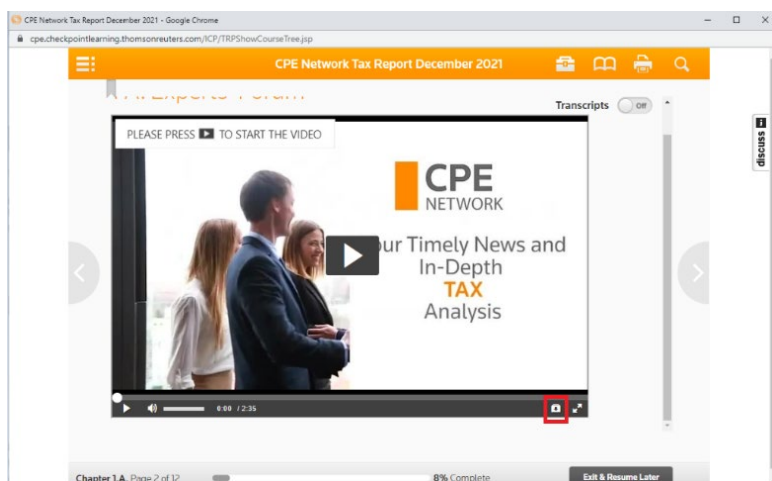


Click down to access the dropdown menu and move between the program Chapters.

- **Course Information** is the course Overview, including information about the authors and the program learning objectives



- Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



Video segments may be downloaded from the CPL player by clicking on the download button noted above. You may need to use the scroll bar to the right of the video to see the download button. **Tip: You may need to use the scroll bar to the right of the video to see the download button.**

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent to administrators with each release.

What Does It Mean to Be a CPE Sponsor?

If your organization chooses to vary from the instructions outlined in this User Guide, your firm will become the CPE Sponsor for this monthly series. The sponsor rules and requirements noted below are only highlights and reflect those of NASBA, the national body that sets guidance for development, presentation, and documentation for CPE programs. **For any specific questions about state sponsor requirements, please contact your state board. They are the final authority regarding CPE Sponsor requirements.** Generally, the following responsibilities are required of the sponsor:

- Arrange for a location for the presentation
- Advertise the course to your anticipated participants and disclose significant features of the program in advance
- Set the start time
- Establish participant sign-in procedures
- Coordinate audio-visual requirements with the facilitator
- Arrange appropriate breaks
- Have a real-time instructor during program presentation
- Ensure that the instructor delivers and documents elements of engagement
- Monitor participant attendance (make notations of late arrivals, early departures, and “no shows”)
- Solicit course evaluations from participants
- Award CPE credit and issue certificates of completion
- Retain records for five years

The following information includes instructions and generic forms to assist you in fulfilling your responsibilities as program sponsor.

CPE Sponsor Requirements

Determining CPE Credit Increments

Sponsored seminars are measured by program length, with one 50-minute period equal to one CPE credit. One-half CPE credit increments (equal to 25 minutes) are permitted after the first credit has been earned. Sponsors must monitor the program length and the participants' attendance in order to award the appropriate number of CPE credits.

Program Presentation

CPE program sponsors must provide descriptive materials that enable CPAs to assess the appropriateness of learning activities. CPE program sponsors must make the following information available in advance:

- Learning objectives.
- Instructional delivery methods.
- Recommended CPE credit and recommended field of study.
- Prerequisites.
- Program level.
- Advance preparation.
- Program description.
- Course registration and, where applicable, attendance requirements.
- Refund policy for courses sold for a fee/cancellation policy.
- Complaint resolution policy.
- Official NASBA sponsor statement, if an approved NASBA sponsor (explaining final authority of acceptance of CPE credits).

Disclose Significant Features of Program in Advance

For potential participants to effectively plan their CPE, the program sponsor must disclose the significant features of the program in advance (e.g., through the use of brochures, website, electronic notices, invitations, direct mail, or other announcements). When CPE programs are offered in conjunction with non-educational activities, or when several CPE programs are offered concurrently, participants must receive an appropriate schedule of events indicating those components that are recommended for CPE credit. The CPE program sponsor's registration and attendance policies and procedures must be formalized, published, and made available to participants and include refund/cancellation policies as well as complaint resolution policies.

Monitor Attendance

While it is the participant's responsibility to report the appropriate number of credits earned, CPE program sponsors must maintain a process to monitor individual attendance at group programs to assign the correct number of CPE credits. A participant's self-certification of attendance alone is not sufficient. The sign-in sheet should list the names of each instructor and her/his credentials, as well as the name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant leaves early, the hours they attended should be documented on the sign-in sheet and on the participant's CPE certificate.

Real Time Instructor During Program Presentation

“Group live” programs must have a qualified, real-time instructor while the program is being presented. Program participants must be able to interact with the real time instructor while the course is in progress (including the opportunity to ask questions and receive answers during the presentation).

Elements of Engagement

A “group live” program must include at least one element of engagement related to course content during each credit of CPE (for example, group discussion, polling questions, instructor-posed question with time for participant reflection, or use of a case study with different engagement elements throughout the program).

Awarding CPE Certificates

The CPE certificate is the participant’s record of attendance and is awarded at the conclusion of the seminar. It should reflect the credit hours earned by the individual, with special calculation of credits for those who arrived late or left early. Attached is a sample *Certificate of Attendance* you may use for your convenience.

CFP credit is available if the firm registers with the CFP board as a sponsor and meets the CFP board requirements. IRS credit is available only if the firm registers with the IRS as a sponsor and satisfies their requirements.

Seminar Quality Evaluations for Firm Sponsor

NASBA requires the seminar to include a means for evaluating quality. At the seminar conclusion, evaluations should be solicited from participants and retained by the sponsor for five years. The following statements are required on the evaluation and are used to determine whether:

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate (if any).
3. Program materials were accurate.
4. Program materials were relevant and contributed to the achievement of the learning objectives.
5. Time allotted to the learning activity was appropriate.
6. Individual instructors were effective.
7. Facilities and/or technological equipment were appropriate.
8. Handout or advance preparation materials were satisfactory.
9. Audio and video materials were effective.

You may use the enclosed preprinted evaluation forms for your convenience.

Retention of Records

The seminar sponsor is required to retain the following information for a period of five years from the date the program is completed unless state law dictates otherwise:

- Record of participation (the original sign-in sheets, now in an editable, electronic signable format)
- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

Here are the forms noted above and how to get access to them.

Delivery Method	Form Name	Location	Notes
"Group Live" / "Group Internet Based"	Advertising / Promotional Page	Transcript	Complete this form and circulate to your audience before the training event.
"Group Live"	Attendance Sheet	Transcript	Use this form to track attendance during your training session.
"Group Internet Based"	Webinar Delivery Tracking Report	Transcript	Use this form to track the 'polling questions' which are required to monitor attendance during your webinar.
"Group Live" / "Group Internet Based"	Evaluation Form	Transcript	Circulate the evaluation form at the end of your training session so that participants can review and comment on the training.
Self Study	CPE Quizzer Answer Sheet	Transcript	Use this form to record your answers to the quiz.

Getting Help

Should you need support or assistance with your account, please see below:

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	844.245.5970	Cplsupport@cerifi.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates