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CPE NETWORK
ACCOUNTING & AUDITING REPORT

JULY 2022 VOLUME 35, ISSUE 6

Note: Beginning with the March 2023 edition of the Network programs DVDs will no longer be shipped by Thomson Reuters. Videos will be available for download or streaming only. For customers wishing to adopt an online only format sooner, please contact your customer representative.

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Topics for future editions may include:

- Rabbi Trusts
- PCAOB Areas of Focus
- SAS 143

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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Russ Madray, CPA discusses FASB guidance on accounting for deferred compensation. [*Running time: 26:40*]

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

- Identify the appropriate accounting guidance and what is required to qualify as a deferred compensation arrangement
- List the benefits of a nonqualified plan

PART 2. AUDITING

Jennifer Louis, CPA discusses the AICPA practice aid on ESG (environmental, social, and governance).The practice aid provides factors to consider in conducting audits of financial statements. [*Running time: 28:19*]

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

- Define ESG and synonymous terms
- Determine who is responsible for the inclusion of ESG related matters in the financial statements
- Identify sources of information related to ESG to gain an understanding
- Identify the auditor's responsibility for ESG related matters in annual reports
- Identify what other areas of the financial statements may be impacted by ESG matters

PART 3. SMALL BUSINESS

Kurt Oestriecher, CPA, reviews the guidance on going concern, who has what responsibilities, and various factors a preparer should consider. [*Running time: 31:22*]

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

- Identify the authoritative guidance on going concern
- Identify facts to be considered in making the going concern evaluation
- Identify considerations to be made of management's plans to mitigate a going concern situation
- Identify where the guidance on liquidation basis accounting is located

ABOUT THE SPEAKERS

Russ Madray, CPA, CGFM, has more than 30 years of professional experience, including stints at two Big 4 accounting firms. Russ is a nationally-known accounting and auditing thought leader, writer, and advisor helping CPAs throughout the country understand and implement technical accounting and auditing issues.

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 Oestriecher, CPA is a CPA and partner with the accounting firm of Oestriecher 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

Accounting for Deferred Compensation

Employee compensation is addressed in four different topics within the Accounting Standards Codification, and today we're focusing on the general guidance found in Topic 710. In particular, we'll be considering the guidance on deferred compensation. Employers can use either a qualified deferred compensation arrangement or a nonqualified one. Both types of plans defer the payment of currently earned compensation to a future date. Qualified plans are compliant with certain federal tax code and ERISA requirements. Nonqualified plans are more flexible with no annual contribution limits and provide a business with access to the funds until the deferred compensation is due to the participants, but do not offer the same tax benefits that qualified plans do.

For more on deferred compensation arrangements, let's join Russ Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk a little bit about deferred compensation. Now FASB ASC 710 addresses an employer's accounting for a variety of compensation related issues, including the deferred compensation arrangements to start with. Could you give us an overview of the guidance related to deferred compensation?

Mr. Madray

Sure. And, to kind of put it in context, you're exactly right about Topic 710. Let's take a look at this slide. You see how it fits in. We have four topics within the accounting standards codification or ASC that deal with compensation. There's 710, which is the general that we'll be talking about, there's 712 that deals with non-retirement post-employment benefits, 715 that deals with retirement benefits and 718 that deals with stock based compensation. Now ASC 710 within itself contains guidance on a number of topics. ASC 710 specifically contains only an overall topic and provides guidance on general compensation related matters that are not within the scope of those other three topics that we just saw on the slide.

That overall topic though, if you look on the next slide contains a couple of subsections that segregates the guidance a little bit further. So the overall topic has two subsections, there's general, and then, deferred compensation rabbi trust. In the general section, we have compensated absences. We also have deferred compensation arrangements that we'll talk about today. There's also guidance with lump sum payments under union contracts, all within that general subsection and in the other one, dealing with a special type of deferred comp arrangements beyond the scope of what we'll look at on today's program, but that deals with something called rabbi trusts. So getting back to what we're talking about, the deferred compensation arrangements, those subsections within Topic 710 do provide guidance for employers that have deferred compensation arrangements. Namely they have to have two characteristics, but they're pretty straightforward. One, the arrangement is part of an individual employment contract. And second, the arrangement is not, in substance, some type of pension or other post-retirement benefit plan. So what we would typically think of as any type of deferred compensation arrangement, as long as it's part of an individual employment contract and not, some type of pension plan it will fall under the guidance in Topic 710 that we'll look at in some detail as we go forward today.

Ms. Grove Casey

Well, I know these types of plans can be qualified or nonqualified. Could you explain the difference there?

Mr. Madray

Sure. And that qualified versus non-qualified deals with essentially tax purposes, but it also will determine how we account for these types of plan. So employers can defer payment of certain employee compensation using either a qualified compensation plan or a non-qualified deferred compensation plan. Both the qualified plans and the non-qualified plans are, again, employment based arrangements that defer payment of currently earned compensation to a future date. Again, the qualified non-qualified refer to whether the plan is in compliance with certain provisions of the federal tax code and ERISA, the Employee Retirement Income

Security Act. Bottom line is non-qualified plans are more flexible because they don't have annual contribution limits and they can provide a business with access to the funds until the deferred compensation is due to the participants.

Unlike qualified plans, employers can elect to offer non-qualified plans only to executives and key employees who are most likely to use and benefit from these types of plans. In non-qualified plans there's no non-discrimination rules, so deferral doesn't need to be offered to every employee throughout the company. Essentially, that gives a company a lot of flexibility in tailoring the plan itself. So, a specific example of a non-qualified deferred comp plan is one called a supplemental executive retirement plan or a SERP that is fairly popular with businesses. Now, although non-qualified plans are not going to offer the same tax advantages as qualified plans, there are still some reasons (we mentioned a couple already) that employers would still offer non-qualified plans. In fact, we have a slide that lists some of these things. A non-qualified plan, for example, can provide additional retirement benefits to employees that readily reach the contribution limits of the qualified plans.

The non-qualified plan can supplement the amount that the employee receives during retirement, beyond what they would get in the capped qualified plan. Non-qualified plans allow the employer to provide additional benefits without those additional administrative burdens of maintaining a qualified plan. And as we said earlier, a non-qualified plan can be offered as a benefit only to certain highly compensated executives because there's no non-discrimination rules that like you would find in in trying to comply with ERISA. With all that said, the accounting for a qualified plan is pretty straightforward. We wouldn't have enough material, I don't think to have a complete program or discussion on accounting for qualified plans because basically you debit compensation expense and credit cash when you make the contribution to the 401k or whatever type of plan it happens to be. On the other hand, accounting for a non-qualified plan is more complex, which is why we're having our discussion today.

We take a look at the next slide. These are the types of arrangements that Topic 710 would apply to and the types of plans that would follow the accounting guidance that we'll be looking at today. First and foremost it applies to post-employment benefits that satisfy the criteria for accrual that are listed in Topic 710, specifically Topic 710-10-25-1. And you see those listed on the slide there. If the employer's obligation to provide compensation results from the employee's past services and the employee's rights, either vest or accumulate and the employer's payment of the compensation is probable and the employer can reasonably estimate the amount of its obligation, then those plans would fall under the accounting within Topic 710 that we'll be discussing today. Beyond that, split dollar life insurance arrangements that are in-substance deferred compensation arrangements also fall under this guidance and finally, any other deferred comp arrangements that are granted to a specific employee by an individual contract rather than through a plan. So it may not be a plan per se offered by the company but maybe it's part of an individual employee employment contract. Again, it would fall under this guidance as well. So to the extent, the terms of any type of employment contract attribute all or a portion of those expected future benefits to an individual year of the employee service, then the cost of those benefits would need to be recognized in that particular year. However, to the extent that the terms of the contract attribute all or a portion of the expected future benefit to a period of service that's greater than one year, then the cost of those benefits would need to be accrued over that period of the employee's service in some systematic and rational manner. Then if there's elements of both current and future service requirements only the portion that is applicable to the current services should be accrued. We'll get into some details and look at some examples of how we do this shortly as we go forward.

Ms. Grove Casey

Well, can you explain the timing of recognition for these plans? In other words, when is compensation expense recognized?

Mr. Madray

Certainly, and that's an important part of accounting for these types of deferred comp arrangements. If the employer/employee have executed a deferred comp agreement of some type, the employer is going to need to recognize the cost of those future benefits earned during the individual service year that's applicable to the agreement. As we said earlier, if the future benefits represent more than one service year, then the employer's going to have to allocate and accrue the compensation cost to each of those service years in some systematic and rational manner. As I said, also, if it includes benefits for both current and future services, the accrual is going to be limited only to the amount that reflects or relates to the services that are performed in the current year. If you take a look at the next slide, this is an example to illustrate that idea of current and future and past service as well.

In this example an employer's deferred compensation contract does not provide a vested benefit for the employee's prior service at the date the contract is entered into. Under the terms of this contract and this example, the employee will need to render 30 years of service in order to receive the benefits under this deferred comp contract. Assume here, the employee is rendered 16 years of service at the date of entering into the contract and assume that that credit is granted for that prior service in determining the eligibility for the benefit to be provided. So with those facts and assumptions, and in that example, the employer would accrue the total obligation under the deferred comp contract, again, in a systematic and rational manner over the employee's future service period to the date that full eligibility for the benefit is attained.

So again, it's 30 years, but a given credit for the 16 already worked. So this is going to need to be accounted for over the next 14 years to get to that point of full eligibility. On the other hand, if the employee is eligible to receive a portion of these benefits without regard to any future service in other words, if the credit for prior service had resulted in a vested benefit, then the obligation for that portion would need to be fully accrued at the time that the contract is entered into and just a side note here, although the employer will need to recognize compensation as an expense when the employee performs work and earns it, federal tax law is going to come into play here and might, may, probably will, prohibit the employer from deducting the item in the computation of their taxable income in that particular period.

Instead, depending on the terms of a particular arrangement the applicable tax law might permit the employer to deduct that only when it's actually paid. So if the employer's a taxable entity, it's still going to need to consider the guidance in Topic 740 to determine whether there's going to be a timing difference here, and whether it results in a recognizable, deferred tax asset. So again, I'm certainly not a tax expert, but that's just something to keep in mind with respect to these types of arrangements. We need to be cognizant, obviously, of the tax impact and ultimately applying Topic 740 to any potential timing differences that could come about as a result of the difference in tax law.

Ms. Grove Casey

Well, can you explain how the amount of compensation expense is determined for the accrual?

Mr. Madray

Sure. In accordance with the guidance in Topic 710, employers are going to need to accrue the cost for the deferred compensation plan, as we mentioned earlier, over the course of the service years assuming there's future service required as part of the plan the employer's going to base their estimate on one or two things, either the life expectancy of each individual employee and other beneficiaries, if that's part of the plan as well, that would be determined using the most current mortality tables that would be available, or they can estimate the amount based on the cost of an annuity that would provide similar benefits over a similar period of time of that life expectancy.

Now that all assumes that the payout of the plan will be over the life of the employee or the other beneficiaries if that's applicable, which is not always the case. Key thing to keep in mind though, is the employer cannot base the estimate on the minimum payout that would be required in the case of an employee or beneficiaries' early death. When the accrual period ends, the employer's accrued liability for the deferred compensation plan will at that point be equal to the present value of the expected benefits that are going to be paid to the employee and beneficiaries, if applicable, and employees' covered dependents. If that's the case, the benefits are essentially compensation for the employees' past services up through that eligibility date. So long story short, let's look at some examples that probably illustrate that a little bit better than just hearing how we go about doing that.

So take a look at the next slide. We have an example where the contract provides only prospective benefits. So here assume the entity enters into a deferred compensation contract with an employee at the date of hire. In this example, the contract provides for a payment of $150,000 upon termination of employment following a minimum three-year service period. The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying that 150,000 by the entity's return on equity for the year. Also let's assume that each year after the third year of service interest at 10% per year is credited on the amount due under the contract at the beginning of the year. So with all that what the employer would have is a liability of 150,000, that would be accrued again in a systematic and rational manner over the employee's first three years of service. Then after the third year of service, that accrued liability would be adjusted annually for the accrued interest and the increased or decreased compensation is based on the entity's return on equity for that year at the end of the third year, and then at each subsequent year of the employee service the amount accrued will be the present value of the benefit that's expected to be paid in exchange for the employee service, if has been rendered up through that that date. So that's an example involving a contract that provides only prospective benefits.

If we go to the next slide, this is an example of a contract that provides retroactive benefits. So here let's assume an entity enters into a contract with a 55-year old employee who has worked five years for the entity. The contract states that in exchange for past and future services and for serving as a consultant for two years after the employee retires the entity will pay an annual pension of $20,000 to the employee that starts immediately after the employee's retirement.

Also let's assume that the expected future benefits to the employer from the consulting services are minimal. So with those facts and assumptions the, the actuarial present value of the lifetime annuity of 20,000, again at the employee's expected retirement date, is accrued. That's a way of coming up with the amount as we mentioned earlier at the date that we enter into the contract, because the employee in this example is fully eligible for the pension benefit at that date. There's no minimum service requirement after that point. Now if the contract in that example had stated that the employee is entitled to the pension benefit only if some of the employee's age and years of service, for example, or 70 or more at the date of retirement, then the employee would be fully eligible for the pension benefit at age 60 after rendering five more years of service. So there, that would change. Because now we'd have to look at the present value of a lifetime annuity of 20,000 again at the expected retirement date that would need to be accrued again in a systematic and rational manner over that five-year service period from the date they enter into the contract to the date that the employee's fully eligible for the pension benefit. It's so important from the accounting purposes to determine, or see the difference in contracts that have prospective benefits, retroactive benefits, and whether or not there's a requirement for future service there.

Now several times in our discussion, I've mentioned accruing in a systematic and rational manner. Topic 710 requires the employer to accrue these deferred compensation benefits through the full eligibility date, but it doesn't establish any kind of specific method for doing this in practice. What you see is typically either a sinking fund approach or benefit/user service approach. Under a sinking fund approach, the employer would base the annual compensation cost or sometimes called annual service cost on the year-to-year change in the present value of the expected future cash flows. Under a benefit/years of service approach to apply this, the employer would divide the present value of the expected future cash flows over the total estimated number of service years until expected payments begin. Also, in either of these approaches the likelihood that the benefits will be forfeited would need to be considered in the actual accrual amount. So some of the core things to keep in mind there in terms of how we might go about accruing those amounts.

Ms. Grove Casey

Well, I know that some of these arrangements include periodic payments, as well as death benefits. Is the accounting different for these types of plans?

Mr. Madray

Yes and no. You're right, some plans will have lifetime periodic payments to the employee and maybe to the employee's surviving spouse as well as a lump sum benefit that's paid on the event of an early death of the beneficiaries. If that's the case, the employee will need to accrue a liability for the estimated amount that it will pay in the future under these types of arrangements. The employee would estimate that amount in accordance with the same steps that we discussed earlier with the couple of examples that we just looked at. They would recognize the liability over the employee's active employment period that begins with the execution of the deferred comp arrangement.

So if we go to the next slide, you'll see an example of, of how this might work. In this example, let's assume an employee becomes fully eligible for benefits under their deferred comp contract five years after entering into the contract. The deferred comp contract says that if the employee dies or becomes disabled, the benefits will be payable immediately. And, again, this is not one of a group of contracts that are essentially a pension plan, because that would take you out of Topic 710. So with those facts and assumptions in this example, if the employee is expected to render service over the next five years, the benefits would be attributed over that service period. Now if death or disability does occur during that five year period, the benefit obligation would be remeasured. Any previously unrecognized amount would be recognized immediately at the date of that event. If the employee is expected to terminate service within the next five years you normally wouldn't make the accrual because the employee is not expected to receive benefits under the plan, but in a rare situation where it's probable that death or disability will occur during the five-year period, then in that case, you would accrue over that relative service period. You can see where that could happen. Hopefully, it would be, in fact, rare.

So a couple of things to kind of keep in mind with respect to these deferred compensation plans as I mentioned earlier Topic 710 doesn't provide any specific guidelines regarding the estimation of the employer's liability for that employee compensation related to these deferred compensation plans and benefits. In the standard, it indicates the employer needs to determine the amount of the liability based on the employee or beneficiary's applicable life expectancies or the cost of an annuity product from an outside insurer, again, assuming a lifetime payout, because these arrangements are in a way similar to an annuity product. And again, one final thing to keep in mind is the employer is prohibited from simply recognizing a liability based only on the arrangement's minimum payout. That's not permitted. So one of those other types of approaches would be necessary in accounting for these types of deferred comp arrangements.

Accounting for Deferred Compensation Arrangements

by J. Russell Madray, CPA

Overview

The Financial Accounting Standards Board *Accounting Standards Codification* (FASB ASC) provides guidance regarding employee compensation in the following four topics:

- FASB ASC 710, *Compensation–General*
- FASB ASC 712, *Compensation—Nonretirement Postemployment Benefits*
- FASB ASC 715, *Compensation—Retirement Benefits*
- FASB ASC 718, *Compensation—Stock Compensation*

FASB ASC 710 contains only the "Overall Subtopic" and provides guidance on general compensation-related matters that are not within the scope of the topics listed above. The "Overall Subtopic" contains the following two Subsections to segregate the guidance:

- General
    - Compensated absences
    - Deferred compensation arrangements
    - Lump-sum payments under union contracts
- Deferred Compensation—Rabbi Trusts

The General Subsections in FASB ASC 710-10, *Compensation–General—Overall*, provide guidance for employers that have deferred compensation arrangements with the following characteristics:

- The arrangement is part of an individual employment contract
- The arrangement is not, in substance, a pension plan or other postretirement benefit plan

Deferred Compensation Plan Types

Employers can defer the payment of employee compensation by using either a qualified deferred compensation plan or a nonqualified deferred compensation plan (NQDC). Both qualified plans and NQDC plans are employment-based arrangements that defer the payment of currently earned compensation to a future date. The terms "qualified" or "nonqualified" refer to the plan's compliance with certain provisions of the federal tax code and the Employee Retirement Income Security Act (ERISA). NQDC plans are more flexible with no annual contribution limits and provide a business with access to the funds until the deferred compensation is due to the participants. Unlike ERISA plans, employers can elect to offer NQDC plans only to executives and key employees who are most likely to use and benefit from them. There are no non-discrimination rules, so deferral need not be offered to the rank-and-file. This gives the company considerable flexibility in tailoring its plan. An example of a nonqualified deferred compensation plan is a supplemental executive retirement plan (SERP).

Although nonqualified plans do not offer the same tax advantages as qualified plans, employers typically offer NQDCs for the following reasons:

- A nonqualified plan can provide additional retirement benefits to employees that readily reach the contribution limits of qualified plans
- A nonqualified plan can supplement the amount an employee receives during retirement to maintain his or her lifestyle
- A nonqualified plan enables the employer to provide benefits without the administrative burdens of a qualified plan
- An employer can offer nonqualified deferred compensation plans as a benefit to only highly-compensated executives

The accounting for qualified deferred defined contribution compensation plans is fairly straightforward—debit compensation expense and credit cash upon contribution to the 401(k) or similar plan. However, the accounting behind NQDC is more complex, as explained below.

FASB ASC 710 applies to an employer's accounting for the following deferred compensation or benefit arrangements:

- Postemployment benefits that satisfy the criteria for accrual as indicated in FASB ASC 710-10-25-1:
    - The employer's obligation to provide compensation results from the employees' past services

- The employees' rights either vest or accumulate
- The employer's payment of the compensation is probable
- The employer can reasonably estimate the amount of its obligation

- Split-dollar life insurance arrangements that are, in substance, deferred compensation arrangements

Observation: Generally, in a split-dollar life insurance arrangement, an employer acquires and owns a life insurance policy that pays benefits on the death of the employee. The employer directs payment of a portion of the death benefits to the employee's designated beneficiary. In the case of a high-dollar policy, the arrangement can be used as an employee benefit to defer compensation.

- Other deferred compensation arrangements granted to a specific employee by individual contract rather than through a plan

To the extent the terms of a contract attribute all or a portion of the expected future benefits to an individual year of the employee's service, the cost of those benefits should be recognized in that year. To the extent the terms of the contract attribute all or a portion of the expected future benefits to a period of service greater than one year, the cost of those benefits should be accrued over that period of the employee's service in a systematic and rational manner. If elements of both current and future services are present, only the portion applicable to the current services should be accrued.

Observation: Under the federal Consolidated Omnibus Budget Reconciliation Act of 1985, (COBRA), an employee maintains the right to participate in an employer's group medical plan when employment terminates. Usually, an employer does not pay for the premiums after employment terminates. In some circumstances, however, employers may continue to subsidize all or a portion of the employee's benefits after termination. If the postemployment arrangement satisfies the conditions for accrual, above, the employer must accrue for the benefits under FASB ASC 710.

Importantly, for deferred compensation arrangements that are in substance pension or other postretirement benefit plans, the applicable guidance is in FASB ASC 715.

Timing of Recognition

If an employer and employee have executed a deferred compensation agreement, the employer will need to recognize the costs of future benefits earned during the individual service year applicable to the agreement. If the future benefits represent more than one service year, the employer must allocate and accrue the compensation cost to each service year in a systematic and rational manner.

If a deferred compensation arrangement provides for benefits in exchange for both current services and future services, the employer limits the accrual for compensation only to the amount that relates to services performed in the current year. The following example from FASB ASC 710-10-55-1 shows how to apply this guideline.

Example 1: Nonvesting Deferred Compensation Contract

An employer's deferred compensation contract does not provide a vested benefit for employees' prior service at the date the contract is entered into. Employees must render 30 years of service to receive benefits under a deferred compensation contract. An employee has rendered 16 years of service at the date of entering into the contract. Credit is granted for that prior service in determining eligibility for the benefit to be provided.

In this example, the employer should accrue the total obligation under the deferred compensation contract in a systematic and rational manner over the employee's future service period to the date full eligibility for the benefits is attained, that is, over the next 14 years. If the employee is eligible to receive a portion of the benefits without regard to future service, that is, the credit for prior service results in a vested benefit, the obligation for that benefit should be fully accrued at the time the contract is entered into.

Observation: Although an employer must recognize compensation as an expense when an employee performs work and earns it, federal tax law may prohibit the employer from deducting the item in the computation of taxable income at that time. Instead, depending on the terms of the arrangement, applicable tax law may permit the employer to deduct the compensation only when paid. As a result, if the employer is a taxable entity it will need to consider the guidance in FASB ASC 740, *Income Taxes*, to determine whether the timing difference results in a recognizable deferred tax asset.

Accrual of Compensation Expense

In accordance with FASB ASC 710-10-25-9, an employer periodically accrues costs for a deferred compensation plan. According to FASB ASC 710-10-30-1, the employer must base its estimate on either:

- The life expectancy of each individual employee (and other beneficiaries, if applicable), as determined by using the most updated mortality tables that are available

- The estimated cost of an annuity that would provide similar benefits

The above is assuming a payout over the life of the employee (and other beneficiaries, if applicable). This is not always the case with deferred compensation plans. Importantly, the employer cannot base its estimate on the minimum payout that would be required in the case of a beneficiary's early death.

When the accrual period ends, an employer's accrued liability for a deferred compensation plan equals the present value of the expected benefits that will be paid to the employee, the employee's beneficiaries, and the employee's covered dependents. The benefits are compensation for the employee's past services through the eligibility date.

The following examples from FASB ASC 710-10-55-1 through 55-10 illustrate this guidance.

Example 2: Contract Provides Only Prospective Benefits

An entity enters into a deferred compensation contract with an employee at the date of hire. The contract provides for a payment of $150,000 upon termination of employment following a minimum 3-year service period. The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying $150,000 by the entity's return on equity for the year. Also, each year after the third year of service, interest at 10 percent per year is credited on the amount due under the contract at the beginning of that year. Accordingly, a liability of $150,000 is accrued in a systematic and rational manner over the employee's first 3 years of service. Following the third year of service, the accrued liability is adjusted annually for accrued interest and the increased or decreased compensation based on the entity's return on equity for that year. At the end of the third year and each subsequent year of the employee's service, the amount accrued equals the then present value of the benefit expected to be paid in exchange for the employee's service rendered to that date.

Example 3: Contract Provides Retroactive Benefits

An entity enters into a contract with a 55-year-old employee who has worked 5 years for the entity. The contract states that in exchange for past and future services and for serving as a consultant for 2 years after the employee retires, the entity will pay an annual pension of $20,000 to the employee, commencing immediately upon the employee's retirement. It is expected that the future benefits to the employer from the consulting services will be minimal. Consequently, the actuarial present value of a lifetime annuity of $20,000 that begins at the employee's expected retirement date is accrued at the date the contract is entered into because the employee is fully eligible for the pension benefit at that date.

If the terms of the contract described in the preceding paragraph had stated that the employee is entitled to the pension benefit only if the sum of the employee's age and years of service equal 70 or more at the date of retirement, the employee would be fully eligible for the pension benefit at age 60, after rendering 5 more years of service. The actuarial present value of a lifetime annuity of $20,000 that begins at the expected retirement date would be accrued in a systematic and rational manner over the 5-year period from the date the contract is entered into to the date the employee is fully eligible for the pension benefit.

Observation: FASB ASC 710 requires the employer to accrue deferred compensation benefits through the full eligibility date, but it does not establish a specific method for doing so. In practice, accountants use either the sinking fund approach or the benefit/years-of-service approach. Generally, under the sinking fund approach, the employer bases the annual compensation cost (or "annual service cost") on the year-to-year change in the present value of the expected future cash flows. Under the benefit/years-of-service approach, the employer divides the present value of the expected future cash flows over the total estimated number of service years until expected payments begin. Also, the likelihood that the benefits will be forfeited should be considered in the accrual amount.

Arrangements with Periodic Payments and Death Benefits

Some deferred compensation arrangements have the following terms:

- Lifetime periodic payments to an employee or the employee's surviving spouse
- A lump-sum benefit payment on the event of an early death of the beneficiaries

An employer will need to accrue a liability for the estimated amount that it will pay in the future under such arrangements. The employer should estimate the amount in accordance with guidance above. The employer recognizes the liability over the employee's active employment period, beginning with the execution of the deferred compensation agreement.

The following example from FASB ASC 710-10-55-1 illustrates this guidance.

Example 4: Attribution Period for a Deferred Compensation Contract

An employee becomes fully eligible for benefits under a deferred compensation contract five years after entering into the contract. The contract states, however, that if the employee dies or becomes disabled, benefits will be payable immediately. The contract is not one of a group of contracts that possess the characteristics of a pension plan.

In this example, if the employee is expected to render service over the next five years, benefits should be attributed over that service period. If death or disability unexpectedly occurs during the five-year period, the benefit obligation should be remeasured and any previously unrecognized amount should be immediately recognized at the date of the event. If the employee is expected to terminate service within the next five years, an accrual is normally not required because the employee is not expected to receive benefits under the plan. However, in the rare situation that it is probable that death or disability will occur during the five-year period, the benefit should be accrued over the relevant service period.

Conclusion

FASB ASC 710-10 does not provide specific guidelines regarding the estimation of an employer's liability for employee compensation, including deferred compensation plan benefits. Instead, FASB ASC 710-10-30-1 indicates that an employer must determine the amount of the liability based on the employee (or beneficiaries') life expectancies or the cost of an annuity product from an outside insurer (assuming lifetime payout), because the arrangement is similar to an annuity product. And, to reiterate, the employer is prohibited from simply recognizing a liability based only on the arrangement's minimum payout.

COMPENSATION GUIDANCE

- FASB ASC 710, Compensation–General
- FASB ASC 712, Compensation—Nonretirement Postemployment Benefits
- FASB ASC 715, Compensation—Retirement Benefits
- FASB ASC 718, Compensation—Stock Compensation

ASC 710 OVERALL SUBTOPIC

- General
  - Compensated absences
  - Deferred compensation arrangements
  - Lump-sum payments under union contracts
- Deferred Compensation—Rabbi Trusts

REASONS TO OFFER NQDCS

- A nonqualified plan can provide additional retirement benefits to employees that readily reach the contribution limits of qualified plans
- A nonqualified plan can supplement the amount an employee receives during retirement to maintain his or her lifestyle
- A nonqualified plan enables the employer to provide benefits without the administrative burdens of a qualified plan
- An employer can offer nonqualified deferred compensation plans as a benefit to only highly - compensated executives

FASB ASC 710 APPLIES TO THE FOLLOWING

Postemployment benefits that satisfy the criteria for accrual as indicated in FASB ASC 710-10-25-1:

- The employer's obligation to provide compensation results from the employees' past services
- The employees' rights either vest or accumulate
- The employer's payment of the compensation is probable
- The employer can reasonably estimate the amount of its obligation

Split-dollar life insurance arrangements that are, in substance, deferred compensation arrangements

Other deferred compensation arrangements granted to a specific employee by individual contract rather than through a plan

EXAMPLE 1: NONVESTING DEFERRED COMPENSATION CONTRACT

- An employer's deferred compensation contract does not provide a vested benefit for employees' prior service at the date the contract is entered into
- Employees must render 30 years of service to receive benefits under a deferred compensation contract
- An employee has rendered 16 years of service at the date of entering into the contract
- Credit is granted for that prior service in determining eligibility for the benefit to be provided

ACCRUAL ESTIMATE

The life expectancy of each individual employee (and other beneficiaries, if applicable), as determined by using the most updated mortality tables that are available

The estimated cost of an annuity that would provide similar benefits

EXAMPLE 2: CONTRACT PROVIDES ONLY PROSPECTIVE BENEFITS

- An entity enters into a deferred compensation contract with an employee at the date of hire
- The contract provides for a payment of $150,000 upon termination of employment following a minimum 3-year service period
- The contract provides for a compensation adjustment for each year of service after the third year determined by multiplying $150,000 by the entity's return on equity for the year
- Also, each year after the third year of service, interest at 10 percent per year is credited on the amount due under the contract at the beginning of that year

EXAMPLE 3: CONTRACT PROVIDES RETROACTIVE BENEFITS

- An entity enters into a contract with a 55-year-old employee who has worked 5 years for the entity
- The contract states that in exchange for past and future services and for serving as a consultant for 2 years after the employee retires, the entity will pay an annual pension of $20,000 to the employee, commencing immediately upon the employee's retirement
- It is expected that the future benefits to the employer from the consulting services will be minimal

PERIODIC PAYMENTS AND DEATH BENEFITS

- Lifetime periodic payments to an employee or the employee's surviving spouse
- A lump-sum benefit payment on the event of an early death of the beneficiaries

EXAMPLE 4: ATTRIBUTION PERIOD FOR A DEFERRED COMPENSATION CONTRACT

- An employee becomes fully eligible for benefits under a deferred compensation contract five years after entering into the contract
- The contract states, however, that if the employee dies or becomes disabled, benefits will be payable immediately
- The contract is not one of a group of contracts that possess the characteristics of a pension plan

GROUP STUDY MATERIALS

A. Discussion Problems

1. Describe the types of plans to which FASB ASC 710 applies.

2. Discuss how an employer estimates the periodic accrual for a deferred compensation plan.

3. Explain how an employer would accrue the liability related to a deferred compensation arrangement with the following terms:

   - Lifetime periodic payments to an employee or the employee's surviving spouse

   - A lump-sum benefit payment on the event of an early death of the beneficiaries

B. Suggested Answers to Discussion Problems

1. FASB ASC 710 applies to an employer's accounting for the following deferred compensation or benefit arrangements:

   - Postemployment benefits that satisfy the criteria for accrual as indicated in FASB ASC 710-10-25-1:

     - The employer's obligation to provide compensation results from the employees' past services

     - The employees' rights either vest or accumulate

     - The employer's payment of the compensation is probable

     - The employer can reasonably estimate the amount of its obligation

   - Split-dollar life insurance arrangements that are, in substance, deferred compensation arrangements

   - Other deferred compensation arrangements granted to a specific employee by individual contract rather than through a plan

2. In accordance with FASB ASC 710-10-25-9, an employer periodically accrues costs for a deferred compensation plan. According to FASB ASC 710-10-30-1, the employer must base its estimate on either:

   - The life expectancy of each individual employee (and other beneficiaries, if applicable), as determined by using the most updated mortality tables that are available

   - The estimated cost of an annuity that would provide similar benefits

   The above is assuming a payout over the life of the employee (and other beneficiaries, if applicable). This is not always the case with deferred compensation plans. Importantly, the employer cannot base its estimate on the minimum payout that would be required in the case of a beneficiary's early death.

3. An employer will need to accrue a liability for the estimated amount that it will pay in the future under such arrangements. The employer should estimate the amount in accordance with other accrual guidance. The employer recognizes the liability over the employee's active employment period, beginning with the execution of the deferred compensation agreement.

PART 2. AUDITING

AICPA ESG Practice Aid

ESG, or Environmental, Social, and Governance has become an area of focus on a global scale over the past decade in particular. ESG is sometimes used interchangeably with sustainability and corporate social responsibility. Recently, the AICPA has jointly issued a practice aid with the Chartered Institute of Management Accountants on the audit considerations of these matters.

For more on this practice aid, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about a recent AICPA practice aid related to ESG, and those matters as they relate to an audit of financial statements to begin with, let's begin, or to start by talking about what ESG generally relates to

Ms. Louis

ESG is the acronym for environmental, social, and governance. You also may hear other terms besides ESG like sustainability reporting or corporate social responsibility reporting. They're all really interchangeable. We're talking about a broad spectrum of information that could be quantitative or qualitative, where people are trying to understand what's the effect of these matters on an organization's strategy or cash flows, financial position, financial performance, and also, trying to decide what's influencing corporate behavior as there may be users of the financial statements. So oftentimes as we think about the environmental component, think about how the entity's exposed to and managing things related to climate related matters, greenhouse gas emissions, renewable energy, those do tend to often be a particular area of focus because of the fact that there could be regulations, and fines and penalties and litigation that could result from these matters.

And it often bubbles up to be a factor to consider in the preparation and fair presentation of the financial statements. Whereas areas like the social component you sometimes could, if we think about fair labor practices, but as we think about other matters, it might be, are you ethically sourcing your materials? Are you thinking about things like privacy and security of data? There may or may not be a direct and material effect on the financial statements. That would be a subject of the audit for those areas, but you're still going to be alert forward and see where there might be greater concern from the governance perspective. It's mostly thinking about the systems of rules and processes such as the structure and diversity of the board and thinking about business ethics, but also executive compensation and other matters like lobbying and political contributions could be a part of governance. So each of these, as we said, could have some element of it that does have an effect on the financial statements, the face financial statements or the disclosures.

Ms. Grove Casey

Why did the AICPA feel compelled to issue a practice aid now? I mean, the sustainability reporting has been gaining traction for well over a decade.

Ms. Louis

That is true. And if you think about the current accounting standards, they have been focusing a lot more on risk and uncertainties, and how changes in the business and operating environment could have a material effect on financial statements and disclosures, and how there's more areas that do require management judgment and estimation. I think naturally as the accounting standards have been re-looked at and revisited, while at the same time you have stakeholders that are putting a heightened emphasis on these matters, that they decided it was a good time to go ahead and at least put some non-authoritative guidance out there.

Ms. Grove Casey

Well, that kind of answers my next question, which is, is the practice aid considered to be authoritative?

Ms. Louis

Well, ultimately, while it comes from the AICPA, it is considered an other publication as we look at what's defined within the Codification of our generally accepted audit standards. So, it is technically non-authoritative. However, obviously it's from a group that is known and trusted, and certainly can be used to come up with some idea about best practices and what would be considered a reasonable response from a prudent person. If we think about an objective party, what would they be looking at and considering? And certainly, the AICPA can fill the void of trying to give that type of non-authoritative guidance.

Ms. Grove Casey

Who is ultimately responsible for ensuring that fairly prepared financial statements include ESG related matters as deemed appropriate?

Ms. Louis

The answer is always going to be management and governance of the organization, because they're responsible for the preparation and fair presentation of their own financials. And this does include risks and uncertainties because of an industry or a regulatory environment or climate change. So these are things that they need to monitor. They need to identify where there could be a direct and material effect on the financial statements, where something could be omitted or misleading or misrepresented, because we haven't really thought about the implications, not just on the debits and the credits, but also disclosures, including risk and uncertainty disclosures that are out there. It is important to consider that. And I think where you do have investors and sometimes the activism on the part of the investors kind of triggers management paying attention to a particular aspect of their environment. But, even without having investors, I'm an owner-managed business, it doesn't mean that I'm immune to the effect of some of these considerations.

Ms. Grove Casey

We talk about those charged with governance quite a bit. And in this case, what role does that group play?

Ms. Louis

Well, those charged with governance is commonly thought of as being an individual or a group that has responsibility for overseeing the overall strategic direction of the entity, including its obligations related to accountability and fair presentation of financial statements. This includes overseeing the financial reporting process. It includes overseeing any external audit of the financial statements that we may have. And therefore, as we think about governance,... there does need to be two-way dialogue, particularly in an audit scenario where the auditors bubble up to say, Hey, here's how we think there could be a relationship to your financial statements and disclosures related to the risks that this entity has because of the environment that you're operating in. But then also governance has the responsibility of sharing their perspective as well, around how they think that everything's being treated the way that it should. So there is accountability to having a free exchange of dialogue between the auditors and governance in order to help oversee what management's doing as we're satisfying the objective, say of a financial statement audit.

Ms. Grove Casey

Well, how do ESG-related matters impact an auditor's determination of materiality on a financial statement audit?

Ms. Louis

Well, ultimately, as we are thinking about the sense of materiality misstatements could include omissions, that may be material where there is a substantial likelihood that, individually or in the aggregate, they would influence judgments that a reasonable user is making on the financial statements. And so there may be things related to omissions of disclosures, omissions of accruals related to some sort of lawsuit that might exist that, ultimately, as we think about things from a quantitative or qualitative point of view, what is it that if we're omitting information about something that it would be considered material within that definition.

Ms. Grove Casey

In general, when an auditor is identifying and assessing risk of material misstatement in an audit, how should an ESG matter such as climate change be considered?

Ms. Louis

So as we think about risk assessment, we're required to understand the entity, understand the environment, understand internal controls that are relevant to that. And definitely all of the different risks that could have an effect, including climate related risks should be considered as part of that process. And that's where we do want to make sure that we think about how is it that this entity is affected by environmental matters? How are they affected by social matters? Do we have an awareness around the conditions that are outside of their control that could actually have an effect in the near term related to this entity's operations? And so we're not required to identify all of the risks that an organization faces. However, as we satisfy our obligations of understanding the entity and its environment, we do need to consider environmental risks and social risks and governance risks that could occur because they could have an implication on the face financial statements and disclosures, particularly things with risk and uncertainty disclosures. And so, as we think about these matters, there actually may be certain, regulations related to say greenhouse gas emissions that we're required to comply with, and so, we may need to understand the internal controls that management has over those matters.

Ms. Grove Casey

Well specifically what sources of information could the auditor review in order to gain an understanding about matters such as climate related matters?

Ms. Louis

Well, as we look at information that may be communicated through the website or press releases, or sometimes even organizations have a sustainability report that is separate and distinct from the audited financial statements that may help provide the auditor with an understanding around climate related matters, but also looking at strategic plans and minutes and budgets, these are all documents that we tend to look at anyhow, but to make sure that we're not glossing over some of the aspects that may not be directly obviously linked to the financials, but yet I can see that they're involved in certain aspects of things that could be something where I want to poke around in the audit process to see whether or not there's implications.

Ms. Grove Casey

Well, let's talk about a few examples of audit procedures that an auditor may perform to respond to the identified risks of material misstatement.

Ms. Louis

Well, it could be that we could be in a situation where we're talking to the reporting entity's legal counsel, their attorneys, to ask them about these environmental, social, governance matters that we look for as we are going through understanding the litigations, claims, assessments brought against the entity, are any of them tied to something like climate risks? So that certainly as we think about the contingent liabilities, both the, when should I accrue for something, what should I disclose about these loss contingencies, which certainly, these could be contributing to pending or threatened litigation, claims, and assessments. But then, we also should think about where management may need to adjust some of their original thinking about how long I'm going to use a piece of equipment. For example, that might change as you are thinking about the useful life of a given matter or how things might be affected as they are predicting the demand for certain products, the useful life of equipment could be reduced because the demand for my product is being reduced. And, I may be losing that demand because of something that's happening on the environmental, social, governance plane. So as we look at procedures, I may need to do some assessment about looking at forecasts, looking at estimates, holding discussions with attorneys would be very specific to having an effect on my audit.

Ms. Grove Casey

Well, how is an auditor's responsibility for auditing compliance with laws and regulations impacted by climate-related matters?

Ms. Louis

Ultimately, an auditor as we think about compliance of laws and regulations is to have a sense of awareness around where non-compliance could have a direct and material effect. We look at legal invoices and we read minutes and we talk to management and non-compliance with things like climate-related regulations, certainly, would be a part of that. Like if I'm prohibited from manufacturing certain vehicles whose emissions exceed a specified amount, a breach of that, ultimately, could have a contingent liability that could affect my financial statements.

Ms. Grove Casey

Are there any special considerations in areas of accounting uncertainty that could be impacted by climate related matters?

Ms. Louis

Well, some of the things, as we think about uncertainty, as I mentioned before, it could be the valuation of a tangible long lived asset, something that's sitting in my PPE, where ultimately it affects viability to continue to maybe use that asset as intended. It could be that I have to think about provisions for something there where I need to reinforce something, right? Or if I tore a bunch of trees down in order to do something in my operations and what's my obligation to replant those trees? It might be that I'm dealing with something with just my brand and things that I'm publicly identified with. And, if they feel that you're contributing to pollution, then that could affect some of my intangible assets. Those are all examples of things where obviously, as we're thinking about these situations, as I think about any of my assets, whether they're tangible or intangible finite lived or indefinite lived, that there's risk around the impairment evaluation of them.

Ms. Grove Casey

Well, are there any other responsibilities related to gathering sufficient, appropriate audit evidence that we should discuss?

Ms. Louis

Sometimes we have to use a specialist as we're looking at these particular matters and they have the requisite skills and expertise in a field other than accounting and auditing that we may need as we're trying to think about the fair presentation and disclosure for those items.

Ms. Grove Casey

What's the most likely issue that will need to be considered when evaluating misstatements for ESG matters.

Ms. Louis

Well, I think one of the important things is to focus on the quality of disclosures. Having complete and understandable and transparent disclosures in general has been an area of focus for financial statement audits. And certainly, these environmental matters present certain risks and uncertainties that could significantly affect the reported amounts of the financial results of the organization in the near term. And so that's part of what I would say is, it's not just, I need to book an adjusting entry with a debit and a credit. It also could be that there's an omitted or misrepresented or misleading disclosure that needs to be aggregated and evaluated as well as we're trying to form an ultimate opinion.

Ms. Grove Casey

Well, how is the evaluation of going concern uncertainty impacted by ESG matters?

Ms. Louis

That's ultimately affected because of the fact that these matters may be where the pending or threatened litigation, claims, assessments are so severe that if I had to pay out on this obligation, this loss contingency, that it could cause my whole organization to unfold but also just disruptions to my business and thinking about the susceptibility that I have to things like extreme weather conditions or thinking about my ability to comply with certain regulations and other types of matters. So certainly we can know because of those things, it could create a greater probability of an organization not being able to meet their obligations when they become due within a requisite look forward period.

Ms. Grove Casey

Are there any special considerations as it relates to required communications with those charged with governance?

Ms. Louis

Well, one of the matters that you're already required to communicate is your view as an auditor about the qualitative aspects of an entity's significant accounting policy practices, their policy elections, their estimates, their disclosures. And so obviously as these matters could affect those items in an entity's financial statements, you're already required to have those conversations around uncertainty with estimates, impairment of assets, degree of subjectivity, as we're preparing those financials.

Ms. Grove Casey

What could be a disclosure matter that may impact fair presentation of financial statements?

Ms. Louis

Well, as we think about the intended users and for them to understand the possible effect of material transactions and events, based on what's conveyed in the financial statements, perhaps there's something about an entity's taking a change in strategy, perhaps they're as an example in the practice aid from the AICPA they talk about moving from manufacturing vehicles that use fossil fuels to electric vehicles. Well, that could have a pervasive effect on my financial statements as a risk and uncertainty type disclosure.

Ms. Grove Casey

Annual reports often include ESG related matters. What is the auditor's responsibility for this other information included in annual reports?

Ms. Louis

There's always going to be information that's required to be in the face financial statements, the disclosures because of your applicable financial reporting framework like GAAP. And then there is going to be an annual report where there is management's discussion and analysis, and where they're able to talk about matters beyond that. And sometimes there's overlap in those areas. An auditor when we have this annual report is obligated to at least read it and to make sure that there's nothing materially inconsistent between the other information in this annual report compared to the audited financial statements and disclosures that are specifically associated with the audit opinion. I'm not required to expand my audit procedures to address these other matters other than reading them and make assessments based on what I already know from the audit and the audit process. But certainly these other matters could include management discussing things like their short and long-term strategies for managing and responding to certain ESG risks.

Ms. Grove Casey

We've been discussing the AICPA practice aid as it relates to audits. What about other attest engagements that address ESG related information?

Ms. Louis

Well, the practice aid is focused on audits. Obviously, you could have an examination or a review that may have implications as well. So you can kind of adapt some of the guidance and principles to those situations. There is a specific AICPA guide on attestation engagements on sustainability information, which does include greenhouse gas emission information. And that, ultimately, can also be used as a tool.

Ms. Grove Casey

We've been discussing the AICPA's perspective about ESG related matters. Does the FASB express any insights from its point of view?

Ms. Louis

Oh, absolutely. Both the FASB as well as international financial reporting standards have been thinking about the connection between these matters and the effect on financial statements. And in fact, they have written a white paper that doesn't modify or change GAAP. It's not intended to be a comprehensive assessment about how ESG matters intersect with financial accounting standards, but it does give some examples and illustrations about how it is that there could be that overlap.

Ms. Grove Casey

So let's talk about how these matters impact the financial statements and the related disclosures.

Ms. Louis

Yes, we we've talked about a lot of them already in the program today, but certainly, as we think about these matters, they have things that may directly affect the financials, but there also could be things that indirectly affect the financials. That would include the loss of my reputation from an environmental contamination that reduces my sales. So they do recognize that from the FASB's point of view, they're trying to figure out what types of matters might merit being some sort of risk and uncertainty that they would care about.

Ms. Grove Casey

Well, it seems that there are many risks and uncertainties that would be faced by ESG related matters. Can you briefly discuss FASB's perspective on how this impacts fair presentation?

Ms. Louis

Yes. I think that the main areas would be already required risk and uncertainty disclosures, things that could significantly affect amounts that are reported in the financial statements, but how they could change in the near term, which is also different than a categorization of disclosures that I would refer to as significant estimates, things that are sensitive to change as it relates to some of the assumptions that are being put into these estimates, like the fact that I could have changes in the fair value of something in the near term and an entity may disclose ultimately the fact that estimation is a point in time thing and actual outcomes may end up being different. So those things particularly, I think, are critical as we're trying to think about those implications.

Ms. Grove Casey

Well, the FASB had issued some guidance on environmental liabilities quite a while back that can be used for some of those E concerns, but what are some other issues that may impact fair presentation of tangible assets as it relates to ESG related matters?

Ms. Louis

Definitely inventory, and what might be the net realizable value of inventory as sometimes regulatory changes renders inventory to be obsolete. Or significant weather events might cause actual physical damage to my inventory or my PPE. There could be changes in consumer behaviors that are affected by social justice matters. So any of your assets really—inventory, PPE, certainly are subject to having concerns about their fair presentation.

Ms. Grove Casey

Well, let's talk about the issues that may impact the fair presentation of those intangible assets as it relates to these. I would think goodwill among others, right? Maybe patents?

Ms. Louis

Yes, and we did talk about those briefly as we were talking about some of the audit issues. I'd want to think about impairment of any long lived assets, whether it's tangible, intangible, finite lived or indefinite lived, and certainly the FASB guidance, the white paper that they wrote really focused on that as well-- about while you do an annual impairment test, it's important to be alert for triggering events where it might be more likely than not, that I've got a problem and environmental matters may be one of those triggering events that would have me go and look at that impairment assessment.

Ms. Grove Casey

Well, are there any other matters that you think merit specific discussion before we wrap up

Ms. Louis

Just highlighting that you could have environmental obligations where you have to remediate contaminated land or something along those lines, that's not a new area, but just reaffirming that, that specifically, that area of the FASB codification would definitely be relevant. But then also don't forget about the tax implications as we're looking at deferred tax assets and how certain tax credit carry forwards and operating loss carry forwards, that there may not be sufficient future taxable income to actually realize those tax benefits, and could there be a valuation adjustment that's needed on those deferred tax assets that's affected by these ESG matters as well.

AICPA Practice Aid – Consideration of ESG-Related Matters in an Audit of Financial Statements

by Jennifer F. Louis, CPA

Background

Environmental, social, and governance (ESG) has become an area of increasing focus. The terms ESG, sustainability, and corporate social responsibility are often used interchangeably. The American Institute of Certified Public Accountants (AICPA) and Chartered Institute of Management Accountants (CIMA) have jointly issued a practice aid titled *Consideration of ESG-Related Matters in an Audit of Financial Statements*. The practice aid is an "other auditing publication" as defined in AU-C section 200, O*verall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards (GAAS)*, and is nonauthoritative.

ESG reporting includes a broad spectrum of quantitative and qualitative information. Interested parties seek to understand the effects of relevant ESG matters on an entity's business strategy, cash flows, financial position, and financial performance. In other cases, parties seek that information from a public policy perspective or to influence corporate behavior. At the same time, management is seeing the benefits of focusing on and communicating information about the risks posed by ESG-related matters, including management's activities and plans for addressing them.

The *environmental* component addresses how an entity is exposed to and manages risks and opportunities related to the environment. For example, climate-related matters, greenhouse gas emissions, renewable energy, natural resource scarcity, pollution, waste, and an entity's impact on the environment would be in the environmental category. Climate-related matters tend to be a primary area of current focus, although ESG can relate to a wide range of matters. Litigation risk due to environmental contamination and other matters would also be placed in the environmental category.

The *social* component encompasses information about an entity's values and business relationships. This category addresses topics such as fair labor practices, the use of ethically sourced material in the production of products, product quality and safety, human capital such as employee health and safety, privacy and data security, community relations, and diversity and inclusion policies and efforts.

The *governance* component of ESG encompasses information about the system of rules, practices, and processes by which an entity is directed and controlled. This category addresses topics such as the structure and diversity of the board of directors, executive compensation, tax transparency, business ethics, critical event responsiveness, entity resiliency, and policies and practices related to lobbying, political contributions, bribery, and corruption.

As stakeholders of financial statements place a heightened emphasis on ESG-related matters, it is important for management and auditors of financial statements to continue to consider how such matters may affect the entity's business and operating environment. Many current accounting standards require an entity to consider changes in its business and operating environment when those changes have a material direct or indirect effect on the financial statements and notes thereto. That is often the case in areas of accounting that require management judgment and estimation.

Management Responsibilities

Management is responsible for preparing the financial statements of the entity in accordance with the applicable financial reporting framework. Risks associated with climate-related changes are considered in the context of the overall environment in which the entity operates. This includes industry factors and the regulatory environment.

Examples of industry factors include the degree of competitiveness within the industry, customer preferences, supplier relationships, and technological developments. Also, risk management measures may require significant expenditures (including long-term technological improvements) and may increase operating costs. Alternatively, entities in industries that do not take such actions may be subject to business disruption and property loss.

The regulatory environment encompasses, among other matters, the legal and political environment in which entities operate. Some entities face uncertainty about future climate regulations. For example, some regulations may create economic disincentives for entities to continue to emit carbon by imposing levies or taxes on high-emission sources, while other regulations may seek to incentivize entities to adopt specific operating practices, such as changing to lower emission or more sustainable land-use practices. The rapid emergence of climate-related legislation in different jurisdictions means that entities need to be aware of existing or proposed climate-related laws and regulations and the extent to which those laws and regulations may affect the entity's operating, investing, and financing activities.

Management may need to consider entity-specific factors such as investor activism or the effects on the entity of shifting consumer preferences for environmentally friendly alternatives. For example, changes in consumer preferences may decrease the demand for certain products and create the need for the entity to obtain new technology and equipment to make innovations in its product, an accomplishment that may be dependent on another entity specific factor – the entity's ability to obtain financing.

Those Charged With Governance Responsibilities

Those charged with governance have responsibility for overseeing the strategic direction of the entity and the obligations related to the accountability of the entity. This includes overseeing the financial reporting process and the external audit. As a result, those charged with governance have a role to play with respect to the consideration of climate-related risks in the context of overseeing the entity's financial reporting process. Examples of responsibilities of those charged with governance as they relate to climate-related matters may include obtaining information about management's risk assessment activities and its plans for mitigating those risks, and exploring with management how climate-related risks may affect the entity's significant accounting policies, accounting estimates, and financial statement disclosures.

An effective audit of the financial statements requires two-way dialogue between those charged with governance and the auditor so that the auditor can understand how risks are being identified and managed at the governance level.

Auditor Responsibilities – Materiality

The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement to enable the auditor to report on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Climate-related risks may affect the auditor's determination of materiality in accordance with AU-C section 320, *Materiality in Planning and Performing an Audit*. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements. Auditors of entities that are affected by climate-related risks may take that into account when determining materiality.

Auditor Responsibilities – Risk Assessment

AU-C section 315A, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires the auditor to obtain an understanding of the entity and its environment, including the entity's internal control as it relates to the audit. In particular, understanding how management assesses and responds to risks (including climate-related risks) may help the auditor:

- Identify risks,
- Determine whether the effect of such risks could give rise to the risk of material misstatement of the entity's financial statements, and
- Develop appropriate audit responses to address these assessed risks.

In obtaining an understanding of the entity, its environment, and its risk assessment process, auditors may find it helpful to obtain information about the following matters:

- Whether and how the entity has considered climate-related risks and opportunities.
- The extent of management's knowledge and awareness of the effects of climate-related matters on the entity, the industry, and geographic locations in which the entity operates.
- Whether the entity has considered the effects of macroeconomic conditions such as inflation, which may occur when climate-related events result in a shortage of an essential component of a product, reducing the availability of the product, causing the price of the product to rise, or causing consumers to move on to a replacement product.

- The process management has used to identify aspects of its operations, suppliers, or markets that may be affected by shifts in consumer preferences towards environmentally friendly alternatives, the transition to low-carbon economies, and the transition by the entity itself to low-carbon alternatives.

- The time horizon management has used in considering climate-related risks.

- How the financial impacts of identified risks have been assessed and incorporated into financial budgeting, projections, and the financial reporting process.

- What management has done to ensure that it complies with emerging climate-related regulations and meets requirements regarding climate-related disclosures in the entity's financial statements, including determining whether it has a reasonable basis for information presented or disclosed in the entity's financial statements.

- Management's decarbonization plan, if applicable.

Reviewing one or more internal or external sources (such as climate-related information disclosed in other information, separately produced sustainability reports, or management communications through press releases and website content) may provide the auditor with an understanding of climate-related matters that may affect the entity and its environment.

Auditing standards require auditors to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level and to design and perform further audit procedures whose nature, timing, and extent are based on, and responsive to, the assessed risks of material misstatement at the relevant assertion level.

If the auditor determines that risks of material misstatement represent a significant risk, the auditor is required by AU-C 260.11 to communicate that to those charged with governance as well as take other steps as outlined in AU-C 315A.

Auditor's Responsibilities – Performing Audit Procedures

AU-C sec. 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained* addresses the auditor's responsibility to design and implement responses to the risks of material misstatement identified and assessed by the auditor in accordance with AU-C sec. 315A and to evaluate the audit evidence obtained in an audit of financial statements.

The following are examples of further audit procedures an auditor might perform to respond to an assessed risk of material misstatement affected by climate-related matters:

- Obtaining third party forecasts of future demand for refined petroleum products to evaluate the potential impairment of assets for an oil and gas refinery.

- Holding discussions with the entity's attorneys regarding climate-related matters and conducting a search for climate litigation and claims brought against the entity to respond to the risk that provisions could be understated or that contingent liability disclosures may be omitted.

- Determining if management has adjusted the residual valuation of equipment and related depreciation expense to reflect a decreased demand for the entity's product and the shortened useful life of equipment used to produce it.

Auditor's Responsibilities – Compliance With Laws and Regulations

AU-C sec. 250, *Consideration of Laws and Regulations in an Audit of Financial Statements* addresses the auditor's responsibility to consider laws and regulations in an audit of financial statements. Climate-related matters may affect the legal and regulatory environment that the entity operates in. An example would be a law or regulation that prohibits the manufacturing of vehicles whose emissions exceed a specified amount. A breach of such law or regulation may have a material effect on the financial statements (e.g., a breach may result in a contingent liability for potential litigation and fines or penalties).

Auditor's Responsibilities – Auditing Accounting Estimates

AU-C sec. 540A, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* addresses the auditor's responsibilities relating to accounting estimates, including fair value accounting estimates and related disclosures, in an audit of financial statements.

The following are examples of estimates included in the financial statements that may be affected by climate-related matters:

- The valuation of property, plant, and equipment after a climate-related event has occurred or when there is a high probability of a recurrence of such an event.
- Provisions for the cost of reforestation of abandoned strip mines.
- The valuation of intangible assets such as an entity's brand after the entity has been publicly identified as being responsible for plastic pollution contributing to carbon emissions.
- The net realizable value of inventory when the entity is affected by regulatory changes that could reduce the demand for a product and thereby make the inventory obsolete, or a significant weather event that causes physical damage to inventory.

AU-C sec. 540 also requires the auditor to obtain sufficient appropriate audit evidence about whether the disclosures in the financial statements related to accounting estimates are in accordance with the requirements of the applicable financial reporting framework and, for accounting estimates that give rise to significant risks, to evaluate the adequacy of the disclosure of estimation uncertainty in the financial statements in the context of that framework. Many of the estimates affected by climate-related matters may have a high degree of estimation uncertainty.

Auditor's Responsibilities – Using the Work of an Auditor's Specialist

AU-C sec. 620A, *Using the Work of an Auditor's Specialist* addresses the auditor's responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence. When auditing areas affected by climate-related matters, a specialist with expertise or specialized skill in a field other than accounting and auditing may be needed.

Auditor's Responsibilities – Evaluation of Misstatements

AU-C sec. 450, *Evaluation of Misstatements Identified During the Audit* addresses the auditor's responsibility to evaluate the effect of identified misstatements on the audit and the effect of uncorrected misstatements, if any, on the financial statements. An example of a circumstance related to climate-related matters that may affect the evaluation of misstatements is the extent to which the misstatement is an omission of qualitative disclosures about environmental matters that present certain risks and uncertainties that could significantly affect the amounts reported in the financial statements as required under the financial reporting framework.

Auditor's Responsibilities – Going Concern

AU-C sec. 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* addresses the auditor's responsibilities in the audit of financial statements relating to the entity's ability to continue as a going concern and the implications for the auditor's report. This section applies to all audits of a complete set of financial statements, regardless of whether the financial statements are prepared in accordance with a general-purpose or a special-purpose framework and includes guidance if events or conditions have been identified that may cast substantial doubt on the entity's ability to continue as a going concern.

AU-C sec. 570 requires the auditor to conclude, based on the audit evidence obtained, whether substantial doubt exists about an entity's ability to continue as a going concern for a reasonable period of time and to evaluate the possible financial statement effects, including the adequacy of disclosure regarding the entity's ability to continue as a going concern for a reasonable period of time. If the auditor concludes that substantial doubt exists, the auditor is required to consider management's plans to alleviate that doubt and to evaluate disclosures regarding these matters.

The following are examples of climate-related matters that could raise substantial doubt about an entity's ability to continue as a going concern, and factors that may or may not alleviate that doubt:

- The disruption of business and the uncertainty created by operating in a geographic location that has a history of being highly susceptible to extreme weather events mitigated by evidence that the entity has leased a plant in, and will relocate to, an area that is less vulnerable to such events.
- Increased compliance costs related to enacted emissions regulations mitigated by a plan developed by a specialist that will enable the entity to comply with those regulations.

- Significant litigation claims by a city vulnerable to sea level rise and flooding against an energy company responsible for carbon emissions and the views of attorneys regarding the likelihood that the litigation will succeed.

Auditor's Responsibilities – Communication With Those Charged With Governance

AU-C sec. 260, *The Auditor's Communication With Those Charged With Governance* addresses the auditor's responsibility to communicate with those charged with governance in an audit of financial statements. One of the matters that AU-C sec. 260 requires the auditor to communicate to those charged with governance is the auditor's views about qualitative aspects of the entity's significant accounting practices, including accounting policies, accounting estimates, and financial statement disclosures. An example of a matter that the auditor may communicate to those charged with governance is the effect of climate-related matters on significant assumptions used in accounting estimates, such as the impairment of nonfinancial and financial assets, and the degree of subjectivity involved in the development of the assumptions.

Auditor's Responsibilities – Forming an Opinion

AU-C sec. 700, *Forming an Opinion and Reporting on Financial Statements,* addresses the auditor's responsibility to form an opinion on the financial statements. It also addresses the form and content of the auditor's report issued as a result of an audit of financial statements.

One of the matters that may impact fair presentation is whether the financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements. An example is disclosure about an entity's strategy to transition from manufacturing vehicles that use fossil fuels to electric vehicles, a strategy that would have pervasive effects on the entity and its financial statements.

Auditor's Responsibilities – Key Audit Matters

AU-C sec. 701, *Communicating Key Audit Matters (KAMs) in the Independent Auditor's Report* addresses the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so. It is intended to address both the auditor's judgment about what to communicate in the auditor's report and the form and content of such communication. AU-C section 701 does not require the communication of key audit matters. Auditing account balances and disclosures impacted by climate-related matters may involve especially challenging, subjective, or complex auditor judgment. Such matters may be communicated to those charged with governance. If so, and the auditor is engaged to communicate KAMs, such matters would be among the matters considered by the auditor as a potential KAM.

Auditor's Responsibilities – Other Information Included in Annual Reports

AU-C sec.720, *The Auditor's Responsibilities Relating to Other Information Included in Annual Reports,* addresses the auditor's responsibility relating to other information, whether financial or nonfinancial (other than financial statements and the auditor's report thereon), including in an entity's annual report. When the auditor has obtained all of the other information at the date of the auditor's report, the auditor is required to include a separate section in the auditor's report with the heading "Other Information," or other appropriate heading.

AU-C section 720 requires the auditor to remain alert for indications that a material inconsistency exists between the other information and the auditor's knowledge obtained in the audit or the other information is otherwise misleading. The following are examples of other information about climate-related matters that might be included in a document containing the audited financial statements and the auditor's report, which the auditor would be required to read and consider in accordance with AU-C sec. 720:

- A discussion of the entity's short and long-term strategy for managing and responding to climate-related risks

- Disclosure of climate-related performance measures, such as carbon emissions attributable to activities that the entity is responsible for

- Potential future effects of climate change on the entity's operations.

FASB Perspective

The Financial Accounting Standards Board (FASB) and the International Financial Reporting Standards (IFRS) Foundation have both issued papers highlighting the connection between ESG-related matters and their effect on financial statements. The FASB's paper does not change or modify current generally accepted accounting principles (GAAP) and is not intended to be a comprehensive assessment of the intersection of ESG matters with financial accounting standards. In addition, the examples included in the paper are illustrative and are not intended to convey additional requirements beyond those in current GAAP. Entities should refer to current GAAP and consider entity-specific facts and circumstances when preparing financial statements.

Some industries may be more affected by certain environmental matters, such as changes in environmental regulations than others. The way in which an entity may consider the effects of ESG matters varies based on the accounting standard being applied and the nature and significance of the ESG matter.

- Some ESG matters may directly affect amounts reported and disclosed in the financial statements, such as the recognition and measurement of compensation expense.
- Other ESG matters may indirectly affect the financial statements. For example, an entity may suffer reputational damage from an environmental contamination that reduces sales.
- Other ESG matters may not have any material effect on the financial statements.

In addition, an entity may consider certain ESG matters as an input to an accounting analysis. For example, a material decline in demand during the reporting period may be a consideration when estimating future cash flows used in a long-lived asset or goodwill impairment analysis.

Subtopic 205-40, *Presentation of Financial Statements—Going Concern*

FASB guidance requires management to evaluate, at each annual and interim reporting period, whether there is substantial doubt about an entity's ability to continue as a going concern within one year after the date that the financial statements are issued or available to be issued. In performing that evaluation, management is required to consider all information that is known and reasonably knowable at the date that financial statements are issued or available to be issued. In its going concern evaluation, management may consider the effects of environmental matters, such as increased compliance costs related to enacted emissions regulations. Also consider other relevant factors that may be material to an entity's ability to meet its obligations as they become due within one year after the date that the financial statements are issued or available to be issued.

If substantial doubt about the ability to continue as a going concern exists, management is required to consider whether its plans alleviate that doubt. Management is required to make certain disclosures if it concludes that substantial doubt exists or that its plans alleviate substantial doubt that was raised. Such disclosures should include information about those matters that were significant to the going concern evaluation.

Topic 275, *Risks and Uncertainties*

FASB guidance requires an entity to provide qualitative disclosures about certain risks and uncertainties that could significantly affect the amounts reported in the financial statements in the near term. Disclosure requirements include information about the nature of an entity's operations and current vulnerability arising from certain concentrations. An entity may determine that the effects of environmental matters are material to the entity in the near term and provide certain disclosures under that guidance.

FASB guidance also requires disclosure of significant estimates that may be particularly sensitive to change. Disclosures are required if it is reasonably possible that assumptions that an entity makes about the future will result in a material change to the carrying amount of assets and liabilities in the near term. The entity may disclose, among other items, the nature of the uncertainty and an indication that it is at least reasonably possible that the estimate will change in the near term. The guidance encourages (does not require) disclosure of the factors that cause the estimate to be sensitive to change, as well as any risk reduction techniques (for example, obtaining insurance) used by an entity.

Topic 330, *Inventory*

FASB guidance requires an entity to initially value its inventory at the cost to bring the inventory to its current condition and location. Inventory measured using any method other than LIFO or the retail inventory method (RIM) is subsequently valued at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation.

When estimating net realizable value, management is required to consider all relevant facts and circumstances. Estimates of net realizable value could be materially affected by a regulatory change that renders inventories obsolete, a significant weather event that causes physical damage to inventories, a decrease in demand for an entity's goods resulting from changes in consumer behavior, or an increase in completion costs because of raw material sourcing constraints.

Subtopic 350-20, Intangibles—Goodwill and Other—Goodwill and Subtopic 350-30, Intangibles—Goodwill and Other—General Intangibles Other Than Goodwill

FASB guidance states that goodwill and indefinite-lived intangible assets (like trade names) are not amortized. Instead, they are tested for impairment at least annually, or more frequently if impairment indicators exist. The direct or indirect effects of an environmental matter could give rise to an impairment indicator. For example, changes in hazardous waste management regulations that adversely affect an entity's operations may be an impairment indicator.

Environmental matters may affect the measurement of an impairment loss. For example, when the matter materially affects the market participant assumptions used to calculate the fair value of the reporting unit (goodwill) or the fair value of the indefinite-lived intangible asset. An entity is required to disclose, among other items, the facts and circumstances that led to the recognition of an impairment loss and the method for determining fair value.

FASB guidance also requires an entity to amortize a finite-lived intangible asset (like client relationships or developed technologies) over its useful life. Useful life is the period in which the intangible asset is expected to contribute directly or indirectly to cash flows of an entity. An entity is required to evaluate the remaining useful life at each reporting period and reflect any changes to the estimate in the financial statements prospectively.

The effect of an environmental matter may be one of many factors that affect the estimated useful life of an intangible asset. For example, an entity may develop a more energy-efficient product to substitute a legacy product, resulting in a change in the estimated useful life of the client relationship intangible asset associated with the legacy product. Alternatively, an entity may acquire the rights to certain green technology that did not perform commercially as expected and, thus, would be subject to an impairment charge. A finite-lived intangible asset is evaluated for impairment in accordance with Topic 360.

Topic 360, Property, Plant, and Equipment

FASB guidance requires an entity to account for long-lived assets (like buildings, machinery, equipment, furniture, and fixtures) at their historical cost. An entity subsequently depreciates the cost of the asset, less any estimated salvage value, over the expected useful life of the asset. The availability of more energy-efficient equipment in the marketplace may result in a decrease in the estimated salvage value of less energy-efficient equipment and/or a decrease in its estimated useful life.

FASB guidance also requires an entity to test a long-lived asset (or asset group) that is held and used for recoverability whenever an impairment indicator exists. Environmental matters could give rise to impairment indicators, such as a material decline in market demand for products or a change in regulation that adversely affects an entity could indicate that a manufacturing plant may be impaired. When impairment indicators are present, an entity is required to evaluate whether the long-lived asset is recoverable (that is, if the undiscounted cash flow projections directly associated with the asset exceed the carrying amount of that asset).

Subtopic 410-20, *Asset Retirement and Environmental Obligations—Asset Retirement Obligations*, and Subtopic 410-30, *Asset Retirement and Environmental Obligations—Environmental Obligations*

Environmental Obligations – FASB guidance requires an entity to consider relevant regulatory, legal, and contractual requirements when accounting for environmental obligations. For example, regulatory requirements to remediate land contamination or fines imposed by the government for failure to meet emissions targets. Entities are required to disclose the nature of the contingency and, in some cases, an indication that it is reasonably possible that the amount accrued could change in the near term. For unrecognized loss contingencies, entities are required to disclose an estimate of the possible loss or range of losses or a statement that such an estimate cannot be made.

Asset Retirement Obligations – FASB guidance applies to contractual and other legal obligations associated with the retirement of long-lived assets that result from acquisition, construction, development, and/or normal operation of a long-lived asset. An asset retirement obligation (ARO) is a liability initially measured at fair value. An entity capitalizes the cost as part of the cost basis of the related long-lived asset and depreciates the asset over its useful life. Environmental matters may affect the recognition, measurement, and disclosure of an ARO in the financial statements. For example, matters related to a legal obligation to remove a toxic waste storage facility at the end of its useful life, or a regulatory requirement to decommission a nuclear power plant or an offshore drilling platform.

Topic 740, *Income Taxes*

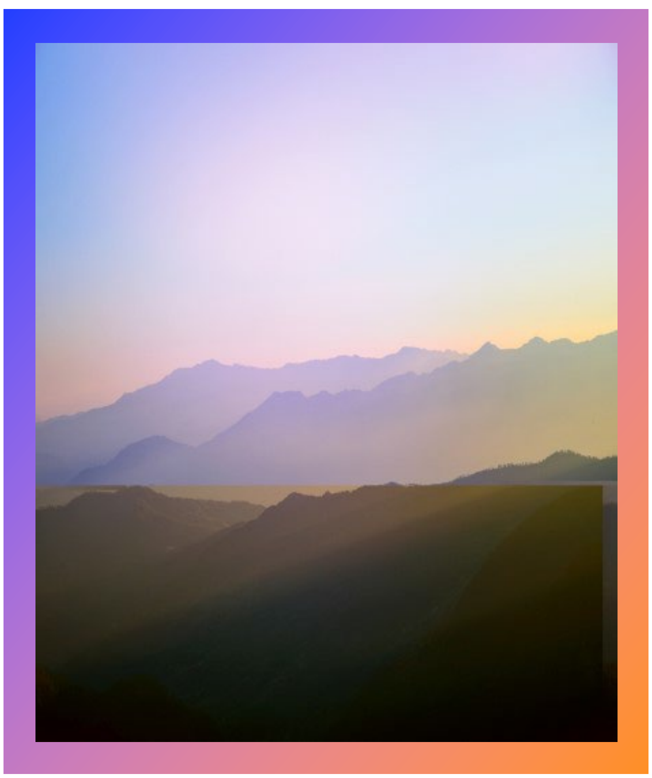
Entities are required to recognize deferred tax assets for deductible temporary differences, operating loss carryforwards, and tax credit carryforwards to the extent that there is sufficient future taxable income to realize the tax benefit. A valuation allowance is recognized if, based on positive and negative evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Environmental regulations could affect estimates of future taxable income. For example, estimates of future taxable income may be affected by projected increases in costs to comply with enacted environmental regulations.

Other Attest Engagements

The AICPA's practice aid does not address considerations for non-audit engagements that address ESG-related information, such as examination and review engagements performed under Statements on Standards for Attestation Engagements (attestation standards). The AICPA's *Attestation Engagements on Sustainability Information Guide* (Including Greenhouse Gas Emissions Information) provides authoritative guidance for performing examination and review engagements that address sustainability information in accordance with the attestation standards.

ESG

- Environmental
- Social
- Governance– group responsible for strategic plan and responsibility for oversight of internal control and financial statements



Responding to Risk of RMM

Talk to Attorneys about ESG while addressing litigation, claims, and assessments

Evaluating Misstatements

Disclosures Need to Be Considered When Evaluating for Misstatements for ESG

DISCLOSURES WITH IMPACT

- Change in Strategy
- Risks and Uncertainties
- Commitments, Contingencies

FASB Concerns

- Intangibles
- Estimates
- Risks and Uncertainties

GROUP STUDY MATERIALS

A. Discussion Problems

1. What are examples of potential environmental, social, or governance risks and opportunities faced by an entity?

2. Discuss management's responsibilities for ESG and the financial statements.

3. Discuss materiality and the auditor's considerations related to ESG.

B. Suggested Answers to Discussion Problems

1. The *environmental* component addresses how an entity is exposed to and manages risks and opportunities related to the environment. For example, climate-related matters, greenhouse gas emissions, renewable energy, natural resource scarcity, pollution, waste, and an entity's impact on the environment would be in the environmental category. Climate-related matters tend to be a primary area of current focus, although ESG can relate to a wide range of matters. Litigation risk due to environmental contamination and other matters would also be placed in the environmental category.

   The *social* component encompasses information about an entity's values and business relationships. This category addresses topics such as fair labor practices, the use of ethically sourced material in the production of products, product quality and safety, human capital such as employee health and safety, privacy and data security, community relations, and diversity and inclusion policies and efforts.

   The *governance* component of ESG encompasses information about the system of rules, practices, and processes by which an entity is directed and controlled. This category addresses topics such as the structure and diversity of the board of directors, executive compensation, tax transparency, business ethics, critical event responsiveness, entity resiliency, and policies and practices related to lobbying, political contributions, bribery, and corruption.

2. Management is responsible for preparing the financial statements of the entity in accordance with the applicable financial reporting framework. Risks associated with climate-related changes are considered in the context of the overall environment in which the entity operates. This includes industry factors and the regulatory environment.

   Examples of industry factors include the degree of competitiveness within the industry, customer preferences, supplier relationships, and technological developments. Also, risk management measures may require significant expenditures (including long-term technological improvements) and may increase operating costs. Alternatively, entities in industries that do not take such actions may be subject to business disruption and property loss.

   Management may need to consider entity-specific factors such as investor activism or the effects on the entity of shifting consumer preferences for environmentally friendly alternatives. For example, changes in consumer preferences may decrease the demand for certain products and create the need for the entity to obtain new technology and equipment to make innovations in its product, an accomplishment that may be dependent on another entity specific factor – the entity's ability to obtain financing.

3. The auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement to enable the auditor to report on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. Climate-related risks may affect the auditor's determination of materiality in accordance with AU-C section 320, Materiality in Planning and Performing an Audit. Misstatements, including omissions, are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements. Auditors of entities that are affected by climate-related risks may take that into account when determining materiality.

PART 3. SMALL BUSINESS

Going Concern

Going concern is a concept that means an entity is expected to continue and most of our accounting guidance is predicated on that belief. While for many years, auditors would have to make a determination related to their clients in terms of reporting, in 2014 the FASB finally issued ASU 2014-15 that brought it into the Accounting Standards Codification. The guidance is located in Topic 205 related to the presentation of financial statements.

For more on making the determination and how to reflect it in the financial statements, let's join Kurt Oestriecher, CPA and a partner with Oestriecher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about a topic that has recently become a great deal of interest to many people, and that is growing concern. Now, that concept actually sits in the concept statements and generally we think of businesses and entities as being a going concern. And we conduct our business with those entities, the transactions, assuming that they will continue as a going concern. But maybe we want to talk a little bit about what is a going concern and why we have to make these disclosures in the footnotes to the financial statements.

Mr. Oestriecher

It started off in the Concepts in the late 1980s, I think it was in the 80s. It didn't go into the 90s and it is interesting when you look at the accruals and investments that are embodied in so many of the accounting standards, it is what you said, it's the assumption that we're going to continue and go on and on and on and on. Kind of like the Celine Dion song a few years ago just goes on and on and on, and that these companies don't die unless either bankruptcy court or management decides, you know what? We've had enough. And so that's the reason we can accrue things. And when we don't have assets and liabilities at their liquidation value we have it based on what used to be pretty much just historical cost.

We have fair value. So all these concepts of how the FASB is establishing standards. It assumes that a company is going to continue to go on in not maybe into perpetuity, but for a reasonable period of time. So we all understand that the value of the assets and liabilities that are recorded in the financial statements and the notes of the financial statement would change drastically if in fact the company would not continue as a going concern. And it's not just a matter of investors could lose money or you shouldn't invest money into this company alone, but in the company, that's kind of the way people see this as a warning sign of, don't invest. But there are some people that have invested money in things that, yes, I know that it could go under, but man, I'll get a thousand and one return on my dollars. I'll put in some money. And that slight hope that we can somehow salvage this, saying, look at Sears or Kmart. I mean, you see people that were dumping money into that as they were closing stores left and right. So certainly the going concern and all the disclosures that we're going to talk about have to do as sort of a warning.

But it is also a warning, I should say, to invest in the company or provide capital to the company. But it's also a warning to the user that, hey, the concepts that are embodied in these financial statements assume there's a going concern, and if there's substantial doubt about that, then, by the way, the assets that we're recognizing, the liabilities and the value in which they're recognized could change because the accounting concepts would change if it's not a going concern. So understand that's the reason that we have this. It's not just this warning to investors.

Ms. Grove Casey

OK, so let's talk a little bit about the authoritative guidance, because for a long time it was the responsibility of the auditor. Right. But then finally, we came to the conclusion that, no, really management is the one who should be making that determination, so it belongs in the financial statements.

Mr. Oestriecher

Right? So in the end, you put it perfectly at the end. And the reason why is that auditing standard is because when this was first broached years ago by the AICPA they talked to the FASB and said, hey, we really think the ball is in your court on this because it's management call it. I think the FASB lobbed the ball back to them and said, no, no, it's going to be on your side of the court. We're not touching this hot potato back in the 1980s. But eventually, it was in 2016, I believe the ASU was issued, it might have been before that, but it has been five or six years ago and the FASB finally said, you know what, you're right? It's management's financial statements and it's their responsibility. So it's something the first part of the Codification section, it starts with the 2s that's before you get to assets and liabilities. So it's a section on presentation. ASC 205-40 is where we have the authoritative guidance and it discusses that it is management's responsibility to evaluate conditions or events. OK, so those are two very broad terms. We'll talk about those that could relate or inhibit the ability of an entity to continue as a going concern for a specified period of time.

And the horizon for that specified period of time that the FASB is going with is one year after the financial statements have been issued, which extends the period that we had when it was in an auditing standard. In an auditing standard it was one year past the date of the balance sheet so now that most financial statements are issued, let's say within 60 to 90 days of year end, it basically extends that 60 to 90 days. There's a lot of discussion about this among practitioners and I teach a lot of CPA courses and wringing of the hands in angst but think about it, how many entities will 60 to 90 days really make that much of a difference? In other words, if conditions or events are there, if you're not going to make it until the end of the year, you're probably not going to make it another two or three months. And I doubt many people would say, yep, well here it is February 27th we were going to be issuing the report March 1st. I think we'll make it to December 31st, but pretty much January 27th next year, that's the end of the road for us. I mean, it generally does not get to that level of precision unless maybe 98% of your revenues are coming from a government contract that expires on that date, and there's no hope for renewing because that division's been cut. I mean, so those are where you have circumstances where everything's tied in. By the way, if you have that, look at your concentration footnote. Hopefully there's been a footnote that's been out there for concentration. So if you have an entity that maybe has and again, even a loan that is due on that date, well, there's ways to refinance loans or get another capital.

So there could be some very specific contract that ties to a specific date that now this going concern, moving it from year end your balance sheet date to one year after the date. The financial statements have been issued. It could have an impact, but for the most part, the types of conditions and events that have events we're going to be looking at, I don't see this as a very problematic move, if you will, as far as the length of the time.

So those are the broad standards, the broad responsibilities, of management. Now, we want to look at the consideration of events and this is where it gets a little bit dicey and expands the scope, if you will, because in the GAAP standard, it talks about management has to evaluate known events or reasonably knowable events. And that's where you start to get out your crystal ball and that's where it gets a little bit dicey.

So let's talk about the known events because that's what we had in the auditing standard. Then let's talk about reasonably knowable events after that. So I think that's the best way to look at this, and try not to conflate the two because you're going to evaluate these differently because there's some subjectivity or the reasonably knowable. You don't even know if it's going to happen or not.

But let's talk about known events, general economic conditions. This is something for the past 10, 15 years, and going back this was a big topic in 2008, general economic conditions. We were looking at possibly the worst recession and we're coming out of COVID now. It all depends on who you talk to.. This is not a political statement, folks, but Covid's always going to be with us. But what we're seeing is that let's call it the crisis, the thought process that the government's going to continue to have shutdowns and quarantines that's looking less and less likely, however, the remnants of all the actions taken, and we're not going to get into the discussion of whether or not you think there were good or bad or whatever but those actions taken have changed the landscape. And it's not just the government money out there and the inflation and all that. It is consumer attitude toward certain items. It is the great resignation people keep wanting to tie this to. Well, people didn't want to go back to work because there's stimulus payments. Nope. They've spent that by now. I personally think that we have families that looked and saw how they function for that three to six month period when people were working at home and home schooling their children have decided, you know what? We can do this with one of the spouses going out and working full time and the other spouse working part time in the house and home schooling children.

I mean, the world as we know it is changing. It has become normal for me to go to the grocery store. I no longer expect to be able to buy everything on my list because I don't expect it to be on the shelves. And I don't blame the president. I don't blame people. Some people want to rant and rave about politicians. It’s just the reality of where we are. Supply chains have been disrupted worldwide. The world is different. Just look at the inflation rate and unemployment rate and all that because quite frankly, I think the unemployment rate is zero because anyone that wants a job can go get one. But there are people looking at it. So how is your entity, the reporting entity, being impacted by these changes? And we're seeing some companies as kind of like the three little bears there.

They're not being impacted much at all. It's steady as she goes. I think my company is an example of that. OK, some companies are actually benefiting because the products and services that they sell are conducive to this newer economy that we're looking at and other companies are going, whoa, wait a second. This is really hurting us a little bit.

We're still seen in the hospitality industry and the rental car company the impact of less business travel, Zoom meetings that have taken over. We used to get on an airplane and go somewhere. It’s all coming full circle, all of the stuff because I can remember a United Airlines commercial in the early 1990s where because people were using telephone and not flying as much and seeing people face to face meetings of this executive where they were losing company or clients. And so he buys everyone around the table an airplane ticket to go visit their customer again. I wonder if we're going to go through that where people lose that personal touch. So I think that, you know, generally economic conditions have more of an impact now on the going concern than it has at any time that I think I have been in practice because we are in unprecedented times and we can listen to all the economists and we know inflation's up, we know interest rates are going up. And really that that to me is less relevant than from a going concern is just consumer changes of tastes. Are we providing the services in today's economy, the goods or services that will have a near impact on what we need to do and that gets into industry specific conditions. That's the next thing that is discussed. And by the way, these are listed within the codification. This is not me just going off the top of my head. So it gets into more industry specific items.

Once when I was playing poker, and the best part about playing poker, by the way, is the table conversation because people love to talk about stuff because you sit there for 4 hours, trying to take each other's money, four or 5 hours. And they were making they call them I think they were calling them the Amazon vans or the Tesla mini vans, you know, where executives for these companies cashed in their stock options years ago it bought the $30,000 minivan. And if they had only held onto to it they would have $2 or $3 million and people are chuckling. And I said, yeah, but those people that have their blockbuster minivans are happy because at least they have a minivan. But it held all of their options. They wouldn't have anything. If we all knew what the future held then, boy investing would be a whole lot easier. But what's going on in your industry? Blockbuster fell more quickly than anyone ever thought it could fall. We are seeing how Uber and Lyft and other rideshare services are dramatically changing [transportation]. I would not like to own a taxi company.

Quite frankly, if I owned a taxi company, I would have a bunch of people working under me under Uber or something. I would try to figure out how to locally franchise Uber or something along those lines. So those are things you need to look at. Changes in technology. How is that impacting the goods and services that you're providing?

Again, consumer habits is another one we talked about that earlier, but is the product or service that you sell, is that something consumers still want or even need as we move forward and a lot of times when you have these types of things, this isn't going to kill you in a year or a year and a half. But if you've seen a steady downward trend in the last two years and it doesn't look like it's going to turn around and go up or that eventually maybe this company won't make it, and so you have to say, we have that critical issue right now, and then those are the external threats.

Internally, do you have management challenges? Do you have a very key member of management who may be near retirement? Recently, Berkshire Hathaway had their annual meeting. And of course, the two stars are Warren Buffett who is 92 and his number two guy. I can't think of his name right now, but I think he's 98 and he was in a wheelchair. And one of the things that came up is, we know they're not going to be around here forever. We know what's going to happen to Warren Buffett. They're like, no, we have people that are coming up behind us and they're ready to step in. But the question is, will they make the same good decisions that the current top two people have always made for Berkshire Hathaway? And if they're capable of making better decisions than Warren Buffett, how come they haven't been elevated now? How come they haven't been promoted now? And again, I don't think Berkshire Hathaway is going to go away within one year of Warren Buffett retiring or the top two or three people retiring. But think at a small company level, you have a founder of the company. Heck, someone could look at that with Oestriecher and Company, CPAs. We just had our 51st anniversary and our managing partner who founded the firm and still our managing partner and up next in line and people might look at our firm there and say you know they may not last long once Mr. O goes. By the way that's my father, that's the managing partner of the firm, so... what is the succession plan for our firm? Fortunately, our firm does have one but if we didn't have one, how long would it take that, hey once the leader's gone, you know, the four or five licensed CPAs all going to start their own firm? Can your law firm, can your medical practice, people always think of a going concern of the big manufacturing companies and things like that, but folks like you, we have small clients that [need that plan].

And by the way, the medical field, the way that's changing that so many physicians are now just signing contracts and they're employed by the hospital. They say, you know what, private practice isn't the place to be now in today's world. And so even though it's an extraordinarily profitable practice, they can make more money and not have to worry of billing and all that. So we're seeing that with some of our medical clients. And again, these are reviewed financial statements or compiled financial statements with disclosures, going concern applies. So you need to look at these internal lack of capitalization or product development, whatever it might be. So this is not when management makes this evaluation. And I know many of the people observing this continuing education, you're a member of management that's having to make this decision, this isn't something that you just think about for 3 minutes one day. It's a lot of checklists. And here back to your auditor or just do internally, if you're issuing financial statements or they're not being audited or reviewed, it is a process that you go through and you want to think about all these various issues.

The thing is, you probably already have if it's a well-run company. You probably are doing strategic planning where, when I think of strengths, weaknesses, opportunities and threats. You're talking about weaknesses and threats, weaknesses are things that I think are internal to the organization, threats are those things that are external to the organization. And so you probably have already identified a lot of these things. I mean, I can't think of any company today that is just sitting back and going, we got to worry about life security. You know, we're just on autopilot and we don't have to change a thing and are going to make a bunch of money. And there are some companies that are like that. I mean, they are out there, but I don't think most companies fit that mold. They understand that there are challenges and the world is changing very quickly.

Ms. Grove Casey

Well, and I think you're right, and I don't know that I ever remember the confluence, let's say, of general economic conditions, changes in technology and the changes in consumer habits all occurring so much overlapping, you know what I mean? So you might have had like a sweet spot between the three of those in the past, but it just seems like they're completely overlaying one another through the pandemic. And the pace of technology change has made a rise in new services and I hesitate to use the metaverse, but when I'm hearing about NFTs and applying those to real estate or artwork right. And that's not like completely an unknown event, right? They're already out there. There are exchanges out there. There are people already paying money for those things. So those kinds of changes. And as you say, consumer habits change over time as well.... It's just going at a faster and faster pace. And I think it just makes it harder and harder for us as professionals to make that informed judgment.

Mr. Oestriecher

A lot of people my age, I'm a lot closer to retirement than I am the beginning of my career, like my late fifties. And there was a man I'm glad by the time all this stuff hits the proverbial fan, I will be retired sort of. But at the same time, I've always liked a challenge and if every year I just came in, did the same thing over and over again for the same clients, I'd be bored out of my mind. And my wife probably would have shot me by now. So it is most of the professional CPAs that I come into contact with, though it all depends on whether or not you had a bad day. If you had a bad day, you are ready to put all this behind you. But I think the general feeling is, yes, we want these challenges.

And quite frankly, part of this process of going concern, I think it has helped CPA firms think more about the challenges that they would have. And then that kind of leads us into that next area, that part that I was involved with, the past. We went there that we have a responsibility to evaluate reasonably knowable events. OK, known events, if you sit there say it's happened, but now you want me to look into a crystal ball and we look at the guidance on reasonably knowable events, it's events or conditions that may not exist at the time, but there's enough information there available that reasonable thought process by management can say, Yep, this is going to happen. You should be able to predict the impact on the company. And again, talk about a Monday morning quarterback type thing because this is where I hate this from a regulatory standpoint or opposing counsel, you know, oh, that was so easy to predict. No, it's not.

For people that have followed me, I'm a big football fan and I'm an LSU fan, and after our 2019 season and for anyone out there that doesn't know, LSU won the national championship that year and before that year we had a quarterback that was probably the third or fourth best quarterback in the SEC and if he had a really good year he might have been drafted third or fourth round. Well, we get a couple of really good receivers and a brainy guy from the Saints and we have this magical season and, Joe Burrow wins the Heisman Trophy and before the year he was 201. If you would have gone and booked a hundred bucks on him in Las Vegas you would have won $20,000. A number of my fellow CPAs and other folks in Louisiana say, we should have seen that coming. It was obvious that he had these great receivers and Joe Burrow was going to be the greatest of all time and that was just so obvious.

No it wasn't. It wasn't obvious because none of us went and put the hundred bucks down. I wish I would have put 100 bucks down. I would have to Vegas. But things that seem so crystal clear after they happen, folks, you got to know what you knew at the time. And there are even things, folks, in a matter of weeks after COVID-19 hit, my attitude toward the impact on my company, and most of my clients changed dramatically because I did not predict the Cares Act. I did not predict PPP loans. I did not predict all these things that would happen. I did not predict that my restaurant clients, I would close down, would now do twice the sale through their drive thru. I did not predict that one of my clients or not a client, but a local fast food place would buy the building behind it for $1,000,000 and tear it down so they could make a longer drive thru line. So now looking back, you go, Oh yeah, well, that was kind of no brainer, it wasn't. So how do you defend yourself if it's two years later? And the company that you're responsible for, your management and you had this responsibility and now your company has gone under, how do you defend yourself? Well, it's by documenting it. And it’s documenting what are the issues that are out there? And if you're not documenting it, then it probably wasn't reasonably knowable unless you just completely missed the boat. So let's say that you didn't even consider the impact of COVID-19 or you did not consider the impact of major legislation that might impact your city if you're in the oil and gas industry. Of course, you're going to be watching what happens with the presidential election, because you know that depending on what party that president's in, that either there are going to be more or less restrictions on drilling in Louisiana. We're very attuned to that. OK, so you can't sit there if you're working in that industry and say, oh, well, we really didn't think that President X or President Y would change the policies of his or her predecessor. Yes they were, they’re in a different party. The policies are going to change. So those are things that are obvious that are going to change or we know that would happen.

So you probably would not get a pass there. But folks, I have sat through college in where I graduated from on their foundation board, and we have very competent advice for our investments and they are admitting, yes, we missed this thing on inflation. I mean, a year and a half ago they're saying, hey, this can be transitionary, that never get above 4% and we'll go back down and I go, Yes, we missed it. And, you know, it was a believable story then. It's a believable story. Now you can only take the information that's out there. So I think the best way you can defend yourself here, and that's really what we're looking at, we're playing defense here, is by documenting your entire thought process, then it's less likely someone can come and challenge you and say, Hey, you should have known that. And then once you identify a reasonably knowable event, then you go through the same process that we talked about for the known events.

Ms. Grove Casey

Well, the other thing we want to take a look at here is management’s response to the conditions or events. And that's part of going through that documentation process, not on the part of the auditor, but on the part of management.

Mr. Oestriecher

And then this is where it gets easier. So you have identified something and then management's going to have a response. And then depending on what the conditions and events are, the response is going to vary. And if management believes that their response will cure the issue, in other words, alleviate reasonable doubt, because remember, we're looking for conditions or events that left unchecked could cause the entity to cease operations one year past the date the financial statements are available. If you don't identify anything, so you say, yes, we have tough times ahead, but we'll make it, then you're done with your evaluation. But if you as management, say, here's an issue. And if we don't do something to fix it, we're dead within 12 to 14 months. OK, now what? You have to evaluate that plan. And there's two things you have to look at. You have to evaluate the likelihood the plan will be implemented, in other words, my plan is, I'm going to go borrow another $23 million, well maybe no one's going to loan you 23 million.... So just because you have a plan doesn't mean it's going to be implemented.

Mike Tyson, that great sage out there, highly intelligent person, he said actually one of the most brilliant things I've ever heard. He said, everyone's got a plan until they get punched in the face. You know, you got a plan. But what happens on that first punch and it doesn't work out. Where are you going to be? So what is the likelihood the plan will get implemented?

And then, secondly, what is the likelihood that that plan will be effective? In other words, maybe you put in the wrong plan and so you execute your plan, but gee, you went about it the wrong way. So if it's probable that the plan will be successfully implemented and it's probable that that plan will mitigate going concern, then you no longer have a going concern issue.

However, you will disclose. We're about to talk about the disclosures, but you still have something to disclose. If management does not conclude that it is probable the plan could be implemented or it's probable that it will mitigate it, now, you actually have a going concern issue in your notes. Let’s talk about the disclosures now. So you won't just disclose, hey, here are the issues, here's our plan. But you have to affirmatively state within that disclosure that management does not believe it is probable that their plans will mitigate the going concern uncertainty and so basically, you are now getting back to where we were under the auditing standard, where management is disclosing that there is substantial doubt about the ability of the entity to continue as a going concern. So management will again disclose what were the issues, what's our plan, and in that, again, you don't think it is probable that it's going to be effective. [I would think that’s] extraordinarily rare these days. Because for management to disclose that, it means that they have identified something that could kill the company and the best plans that they can think of aren’t going to work. So how are you going to get anyone externally to invest in the company or to care about the company? When management is saying we can't fix it. First of all, if I'm on the board of directors of that company, I’m going to immediately fire management because we got problems. I'm here to protect shareholders and you've admitted you can't come up with a plan that you think will work.

So that's kind of interesting. That's why I don't think we'll ever see that. I think we're going to see most of the time what we have seen on Sears, even though most people think Sears is pretty much dead, but they keep going. I think they're down to three Kmart stores, and one Sears store or something in this kind of a real estate holding company now.

But for the last four or five years, they've had what I call the yellow light disclosure. And that's where management does, in fact, see or there are conditions and events that could lead to substantial doubt. However, management has a plan, and they believe it is probable that it will work and that will keep the company afloat for at least the next what 12 to 14 months, one year past the date, the financial statements are available to be issued. And that's what I call the yellow-light disclosure. When this was an auditing standard, you did not have to have that disclosure. If you thought the plan would work, then nothing was disclosed and it just stayed in the audit work papers. Now you have to disclose the conditions and management's plan and that's what we're going to see most commonly.

I have yet to actually find an example of a company that has what I call the red-light disclosure because any company that would disclose that they probably are already in liquidation or bankruptcy, which we have the liquidation basis of accounting. But that's a whole other story. I think Russ Madray did something with you on this, where there's a great thing out there on the liquidation basis. Any company that would say, Hey, we're done for would probably be adopting the liquidation basis at that point because their plan is to liquidate the company. So that's why I don't think we're going to necessarily see that red-light disclosure out there. The most common will be that yellow-light disclosure.

Ms. Grove Casey

Well, do you want to talk about what needs to go into the disclosures or do you want to talk about the liquidation basis of accounting? Because maybe we want to discuss that a little bit to let people know where to go if they do have a going concern opinion that in effect becomes reality.

Mr. Oestriecher

If you conclude that the company is going under, and management has to have adopted a plan of liquidation or externally like a bankruptcy court or regulator said, no, we're going to liquidate. And that guidance is right underneath the going concern. It's actually in Section 205-30 where they say now you're going to recognize assets and liabilities that maybe are an internally developed item like a trademark. You will recognize that at liquidation value, which sometimes could be fair value so you convert your assets and liabilities to what you expect to get in liquidation. And then in your summary of significant accounting policies. You state in a word we're on the liquidation basis of accounting. We're not on a going concern basis.

So like I said, it's kind of a topic that you kind of segue into the going concern once you get to that red light disclosure because again, that means that our best plan is not going to work and that's what happens to a company when they cease operations, either management liquidated the assets and liabilities or somewhere else like a bankruptcy court liquidates our assets and liabilities.

Going Concern

by Kurt Oestriecher, CPA

Introduction

The impact of the COVID-19 pandemic and resulting changes in the economy and consumer behavior has put the going concern disclosure requirements back in the spotlight. ASC 205-40 provides the guidance for financial statements issued in accordance with United States GAAP, and should be consulted by those that are responsible for issuing financial statements or providing audit, review, or compilation with full disclosure engagements.

Requirements

An entity's management should evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. Management's evaluation should be based on relevant conditions and events that are known and reasonably knowable at the date that the financial statements are issued. Substantial doubt about an entity's ability to continue as a going concern exists when it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued.

Evaluation horizon

ASC 205-40 requires management to evaluate conditions and events that could cause a going concern issue through the period ending one year after the date the financial statements are issued. The expected date of the issuance should be noted when documenting going concern considerations so that the evaluation horizon is identified.

Known events

While many conditions that may influence the viability of a business may exist, known conditions that can cause substantial doubt of continued existence must first be considered. These conditions may fall into the following general categories:

- General economic conditions
- Industry specific economic conditions
- Changes in technology
- Changes in consumer tastes
- Internal issues
  - Changes in management
  - Lack of capitalization
  - Lack of product development

In the evaluation of going concern, all of the factors above would be considered known factors that should be evaluated by management. While no one factor is considered to have greater weight than any other, internal and industry specific factors are typically more likely to have more of a near-term impact on an entity than general economic conditions.

Reasonably knowable events

Reasonably knowable events and conditions are issues that may not exist at the time that management is evaluating going concern, but based on all available information, it is reasonable that management should be able to predict the effects on the company.

This requirement has been somewhat controversial as it is always easy to look back after a significant event has happened and, in hindsight, believe that it was reasonable that such an event could have occurred. While the controversy will never go away, the person or persons responsible for the evaluation are in a better position to defend their evaluation if there is documentation of the discussion of reasonable knowable events and conclusions reached.

Management's response to known or reasonably knowable conditions or events

When management identifies conditions or events that raise substantial doubt about an entity's ability to continue as a going concern, management should consider whether its plans that are intended to mitigate those relevant conditions or events will alleviate the substantial doubt. The mitigating effect of management's plans should be considered only to the extent that:

(1) it is probable that the plans will be effectively implemented and, if so,

(2) it is probable that the plans will mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

When evaluating whether or not the plan(s) can be effectively implemented, management should consider the factors that could impede the implementation of the plan. If part of the plan is to obtain additional capital, the ability to persuade debt or equity investors should be considered in light of the current environment, including previous attempts to obtain capital. If an entity has been unable to obtain additional capital after repeated attempts, this information would indicate that while the additional capital would alleviate the going concern issue, it is not probable that the plan could be implemented.

<u>Disclosure requirements</u>

Substantial doubt alleviated

If the substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans)

b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations

c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

Substantial doubt not alleviated

If substantial doubt is not alleviated after consideration of management's plans, an entity should include a statement in the footnotes indicating that there is *substantial doubt about the entity's ability to continue as a going concern* within one year after the date that the financial statements are issued (or available to be issued). Additionally, the entity should disclose information that enables users of the financial statements to understand all of the following:

a. Principal conditions or events that raise substantial doubt about the entity's ability to continue as a going concern

b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations

c. Management's plans that are intended to mitigate the conditions or events that raise substantial doubt about the entity's ability to continue as a going concern.

<u>Sample Disclosures</u>

Example 1 – Substantial doubt alleviated

Assumptions

Company XYZ is a small business that provides third party logistics services and is the last link in transporting retail merchandise to stores that typically are located in large shopping malls. The decrease in suburban mall shoppers and the increase in diesel prices has threatened margins to the point where substantial losses could occur. While diesel prices may reduce from the current peak, consumer shopping habits are expected to continue the trend of using on-line retailers, further reducing revenues.

Management of Company XYZ has successfully re-negotiated its current contracts so that more favorable fuel surcharge revenue will be realized. The vehicles used by the company are leased, and management is currently negotiating with the lessor to swap the current lease vehicles with more fuel-efficient hybrid vehicles. Both of these actions are believed to be sufficient to successfully reduce the impact of increasing fuel prices.

Management is also currently negotiating with a large on-line retailer to handle overflow packages that cannot be handled by UPS, FedEx, or the United States Postal Service. The contract is expected to provide substantial revenues and the current fleet and driver force will not need significant changes or training to transition to final consumer delivery.

Note 13 – Uncertainty – Going Concern

Management has determined that the current consumer trend of on-line retail shopping, combined with unexpected increases in fuel costs have created conditions that could raise substantial doubt about the ability of the entity to continue as a going concern for one year past the date the financial statements were issued.

Principal conditions and events

The company's primary source of revenue is from delivering retail products to stores that are typically located in suburban malls. Consumer purchasing preferences is continuing to shift to the on-line environment, reducing both the number of stores and amount of merchandise delivered to those stores. In addition, record fuel prices have caused expenses to drastically increase at a time when revenues are decreasing. The combination of these two factors could cause the company to incur significant losses, and therefore discontinue operations.

Management's evaluation of the conditions and events

While fuel prices are reasonably expected to decrease, it is uncertain when this will happen and the extent of the decline before fuel prices stabilize. However, management must assume that fuel prices will remain stubbornly high for a reasonable period of time and steps must be taken to either reduce fuel usage or negotiate fuel surcharges with the customer.

Management believes that consumer preferences will continue to shift retail shopping away from traditional malls to online and single store locations. The current customers of the Company do not typically have single store locations, therefore the number of merchandise units that will be delivered on an annual basis are expected to continue to decline.

Management's plans that alleviated substantial doubt about the ability of the entity to continue as a going concern

Management has successfully re-negotiated its current contracts so that more favorable fuel surcharge revenue will be realized. The vehicles used by the company are leased, and management is currently negotiating with the lessor to swap the current lease vehicles with more fuel-efficient hybrid vehicles. Both of these actions are believed to be sufficient to successfully reduce the impact of increasing fuel prices.

Management is also currently negotiating with a large on-line retailer to handle overflow packages that cannot be handled by the current delivery infrastructure. The contract is expected to provide substantial revenues and the current fleet and driver force will not need significant changes or training to transition to final consumer delivery. The negotiations are expected to be successful and the contracts will be in place this fiscal year.

Example 2 – Substantial doubt not alleviated

Assumptions

Company ABC is a manufacturing company that has been in existence for 6 years and is primarily engaged in developing and manufacturing automated counters to be used by pharmacies in dispensing and filling prescription medications. The company has had some limited success in developing and marketing machines, but the holy grail of a universal pill counter that can be used to dispense every drug currently in the United States market has proved elusive

The company started with an initial investment of $500,000 from its original owner, a pharmacist who believed that he had "cracked the code". After the initial investment was used, the owner mortgaged his home for an additional $300,000 in capital. Faced with higher than expected legal and development costs, the owner obtained additional capital from a venture capital company. The agreement called for up to $4,000,000 in additional capital investments, which would be in the form of convertible preferred shares.

The company has issued $3,600,000 in preferred stock, and is expected to issue the final $400,000 in the first quarter of the next fiscal year. The company currently has $125,000 in available working capital. Management is unsure if the remaining $525,000 will be sufficient to get a product to market.

Management has been attempting to convince the current investor to subscribe to $2,000,000 in additional shares, but the investor has declined. Bank financing is out of the question due to lack of collateral, and any additional investor would probably not take a secondary position to the current investor. In addition, the preferred shares will be converted to common stock at the end of the second quarter in the event that the preferred dividends are not paid.

Note 19 – Uncertainty – Going Concern

Management has determined that there is substantial doubt about the ability of the entity to continue as a going concern for one year past the date of the issuance of the financial statements, February 22, 2022.

Principal conditions and events

The company develops and manufactures medical equipment, specifically pill counting machines that are designed to be used by pharmacies. While management believes that the company has the technical and engineering expertise that will enable the company to develop a patent that will be used to develop a machine that will be marketed nationwide, the company may not have sufficient capital to complete the project and obtain the patent.

The company is financed primarily from a venture capital source, and only $400,000 in available funds remain from the principal investor. Management has predicted that an additional $2,000,000 in funding is required to bring the product to market. The principal investor is unwilling to commit additional funding, and is likely to exercise their right to convert their preferred stock to common stock on June 30, 2022 if dividends are not paid. The conversion rate will allow the investor to obtain 80% of the outstanding shares of the stock. It is likely that if such a conversion takes place, the investors will sell the technology that has been developed through that date to a competitor in order to recoup their investment. If such actions are taken, the company will have no marketable assets and will likely liquidate.

Management's evaluation of the conditions and events

Marketing data suggest that the company will be able to recover all development costs within 2 years after going to market. Profit margins on the machines are expected to be 76% for the life of the patent. Because of this very high profit potential for 15 years, management believes that the value of the technology developed to date far exceeds the fire sale value that is anticipated by the investor.

Relations with the current investor are strained, and traditional bank financing is not viable. The preferred shareholders do not share the optimistic outlook of management and are ready to move forward.

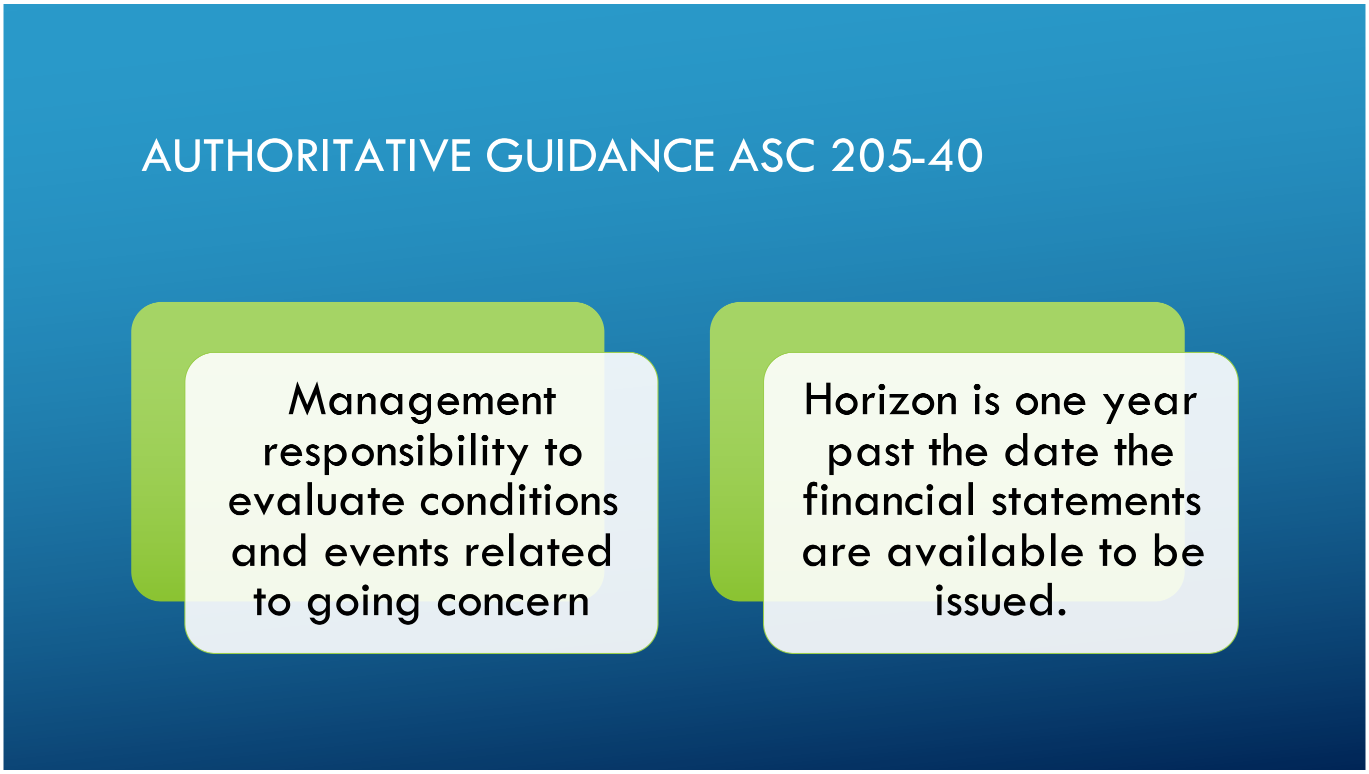
Management does not believe that it is possible to bring a viable product to market with the limited capital remaining by June 30, 2022. Without a capital infusion that not only provides additional capital, but also redeems the $3,600,000 of currently issued preferred stock, it is likely that all viable assets will be sold and the company will cease operations.

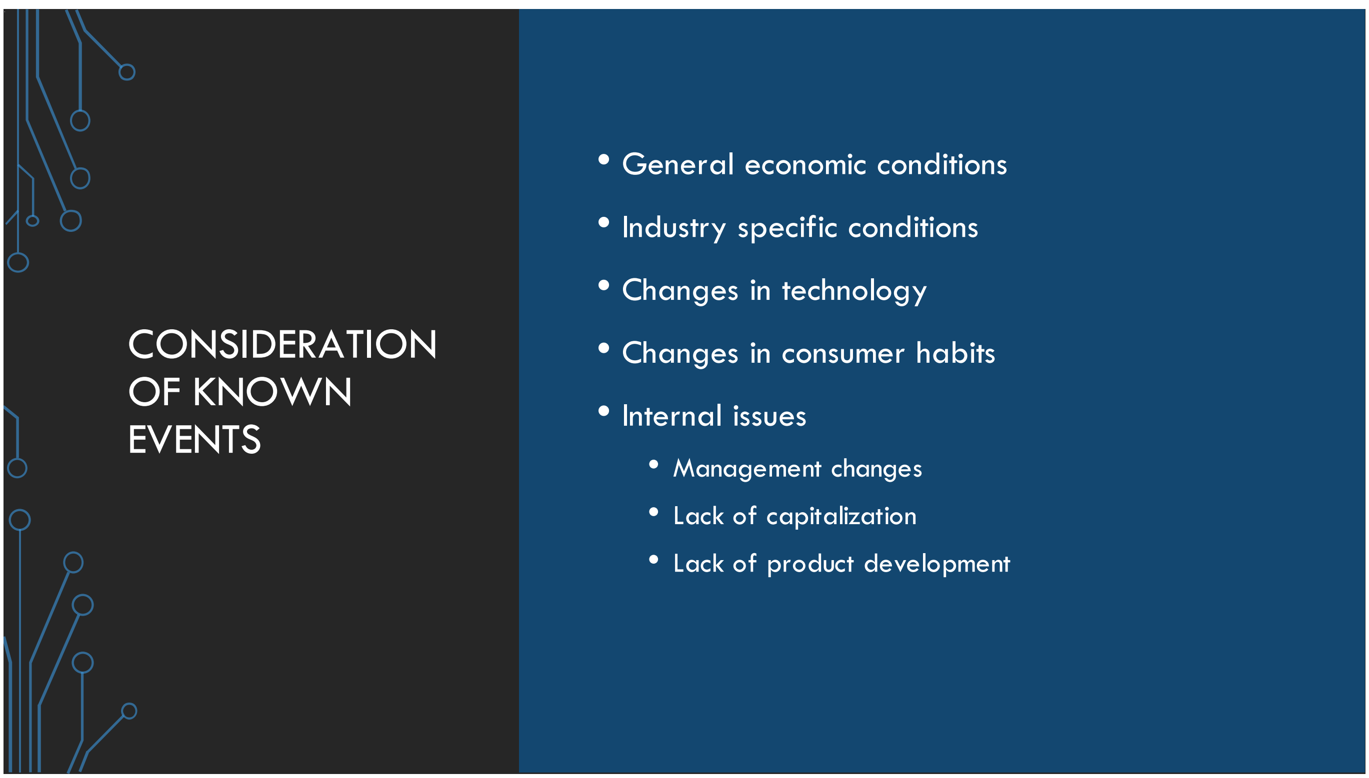
Management's plans to mitigate substantial doubt about the ability of the entity to continue as a going concern

Management has hired a consulting firm to assist in a private placement that will secure $6,000,000 in additional funding. The investment will be in exchange for 30% of the outstanding voting stock, but will give the investor a supermajority of the board of directors. There has been interest expressed from some sources. Due to the legalities and the need for due diligence by any potential investor, it is necessary to receive a commitment by May 15, 2022.

Summary

The going concern disclosure requirements should be addressed any time a company is issuing financial statements in accordance with United States GAAP. Recent auditing standards have updated the audit report to emphasize the responsibilities of both management and the auditor related to going concern evaluation and disclosure. Concise documentation of all discussions and conclusions related to the evaluation of going concern disclosures will protect the responsible parties in the event of litigation or regulatory compliance issues.


AUTHORITATIVE GUIDANCE ASC 205-40
Management responsibility to evaluate conditions and events related to going concern
Horizon is one year past the date the financial statements are available to be issued.

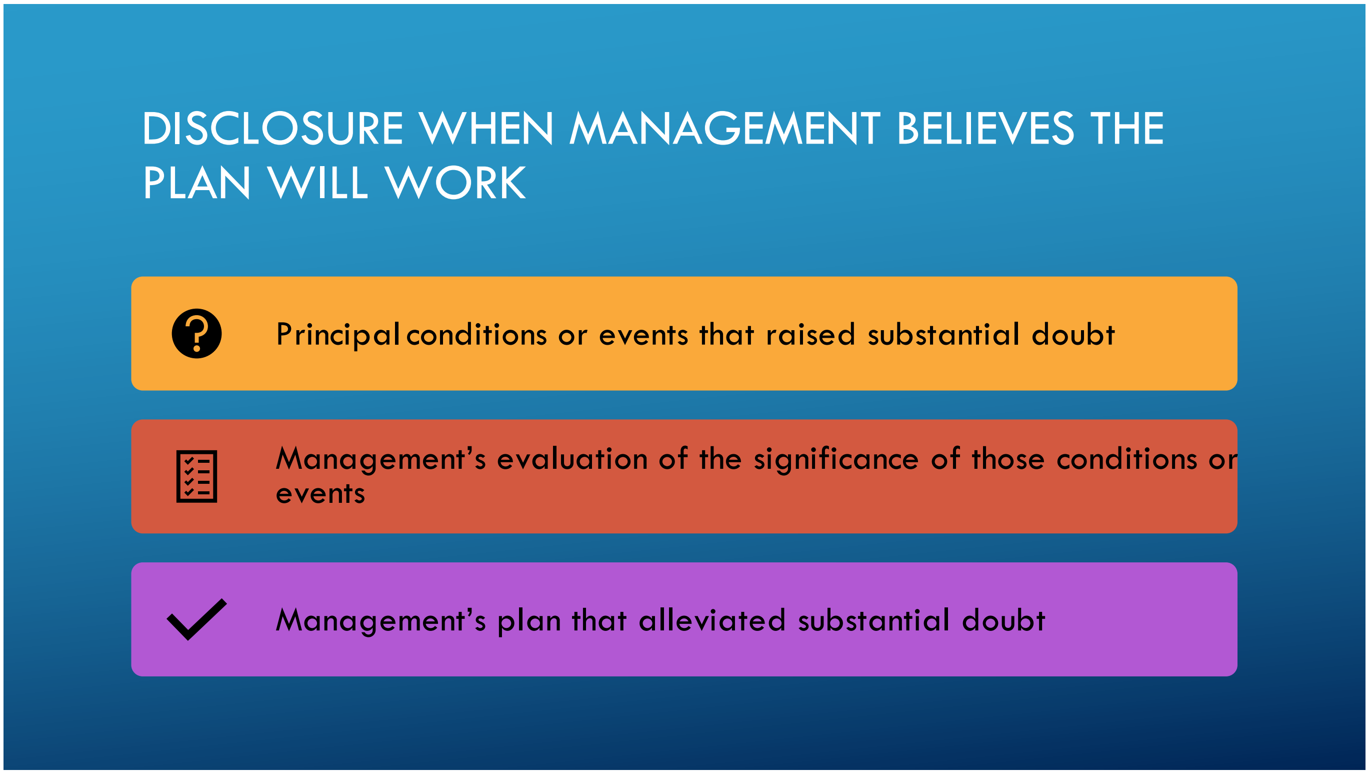

CONSIDERATION OF KNOWN EVENTS
• General economic conditions
• Industry specific conditions
• Changes in technology
• Changes in consumer habits
• Internal issues
• Management changes
• Lack of capitalization
• Lack of product development

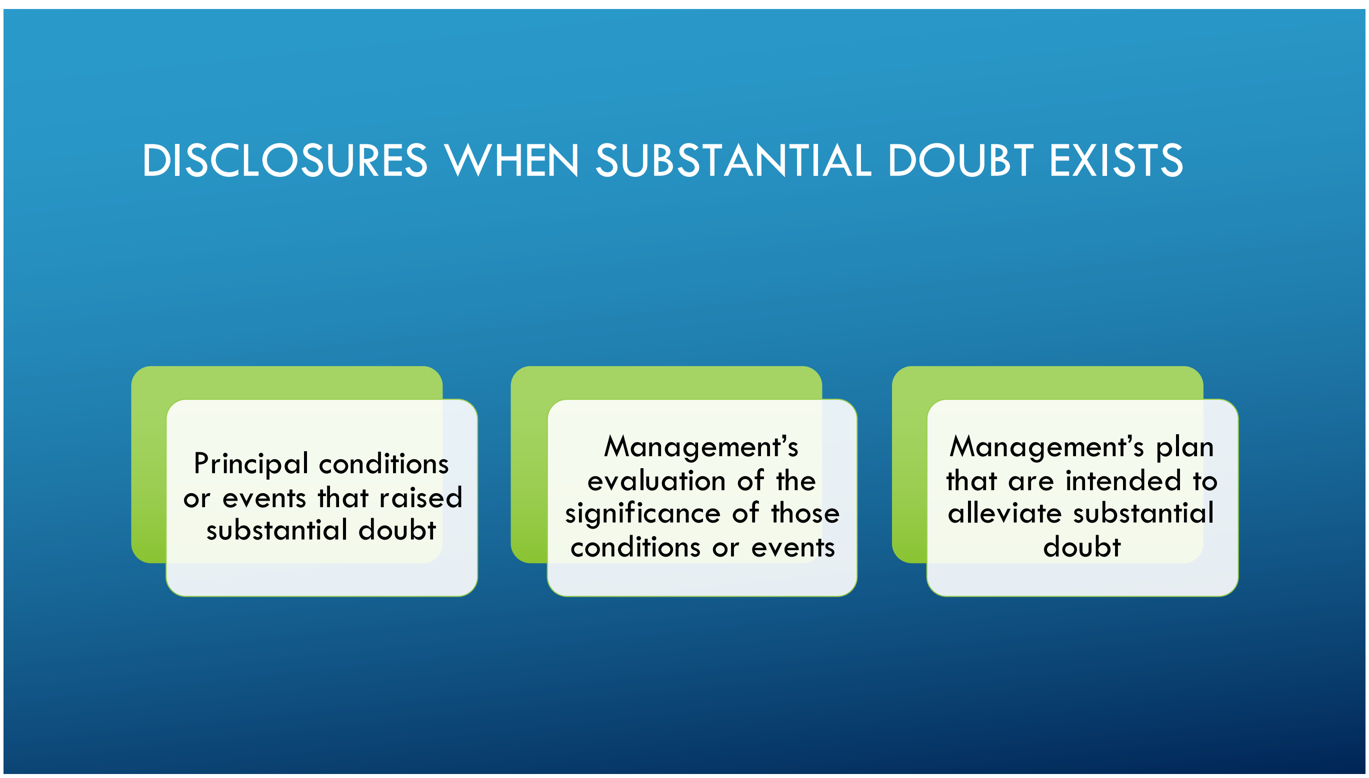
Events and conditions that are issues that may not exist at the time management evaluates going concern, but based on all available information, it is reasonable that management should be able to predict the effects on the company.

CONSIDERATION OF REASONABLY KNOWABLE EVENTS

MANAGEMENT RESPONSE TO CONDITIONS OR EVENTS

- How is management going to address conditions or events
  - Is it ***probable*** the the plans will be effectively implemented
  - Is it ***probable*** the the plans will mitigate the conditions or events that raise substantial doubt


DISCLOSURE WHEN MANAGEMENT BELIEVES THE PLAN WILL WORK
Principal conditions or events that raised substantial doubt
Management's evaluation of the significance of those conditions or events
Management's plan that alleviated substantial doubt


DISCLOSURES WHEN SUBSTANTIAL DOUBT EXISTS
Principal conditions or events that raised substantial doubt
Management's evaluation of the significance of those conditions or events
Management's plan that are intended to alleviate substantial doubt

(*

LIQUIDATION BASIS OF ACCOUNTING

ASC 205-30

- Present using liquidation basis when liquidation is ***imminent***
  - A plan for liquidation has been approved by those with authority
  - A plan of liquidation has been imposed by other forces
- Recognize all assets that will be liquidated, even if not previously recognized
  - Trademarks
- Revalue assets to estimated liquidation value
- Accrue estimated disposal and other costs

A. Discussion Problems

1. Discuss the time period management needs to consider for the going concern evaluation.

2. Discuss categories of known conditions related to substantial doubt of continued existence.

3. Discuss the disclosure requirements if substantial doubt is alleviated as a result of consideration of management's plans.

B. Suggested Answers to Discussion Problems

1. ASC 205-40 requires management to evaluate conditions and events that could cause a going concern issue through the period ending one year after the date the financial statements are issued. The expected date of the issuance should be noted when documenting going concern considerations so that the evaluation horizon is identified.

2. While many conditions that may influence the viability of a business may exist, known conditions that can cause substantial doubt of continued existence must first be considered. These conditions may fall into the following general categories:

   - General economic conditions
   - Industry specific economic conditions
   - Changes in technology
   - Changes in consumer tastes
   - Internal issues
     - Changes in management
     - Lack of capitalization
     - Lack of product development

3. If the substantial doubt is alleviated as a result of consideration of management's plans, the entity should disclose information that enables users of the financial statements to understand all of the following:

   a. Principal conditions or events that raised substantial doubt about the entity's ability to continue as a going concern (before consideration of management's plans)

   b. Management's evaluation of the significance of those conditions or events in relation to the entity's ability to meet its obligations

   c. Management's plans that alleviated substantial doubt about the entity's ability to continue as a going concern.

GLOSSARY OF KEY TERMS

Deferred Compensation—a portion of an employee's compensation that is set aside to be paid at a later date.

ERISA—Employee Retirement Income Security Act

ESG—Environmental, Social, and Governance

Going Concern—the assumption that an entity will remain in business for the foreseeable future or at least the next 12 months

Net Realizable Value—the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation

Risk of Material Misstatement—the risk that the financial statements are materially misstated prior to audit.

SERP—Supplemental Executive Retirement Plan

CUMULATIVE INDEX 2022

BY TOPIC

BY CITATION

BY SPEAKER

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

1. According to Russ Madray, which of the following ASC sections addresses retirement benefits?

A. ASC 710.
B. ASC 712.
C. ASC 715.
D. ASC 718.

2. According to Russ Madray, the accounting for which of the following is ***not*** addressed in the general portion of ASC 710?

A. Compensated absences.
B. Deferred compensation arrangements.
C. Lump sum payments under union contracts.
D. Rabbi trusts.

3. According to Russ Madray, which of the following is a requirement of a deferred compensation arrangement?

A. The arrangement is part of an individual employment contract.
B. The arrangement is part of a group plan.
C. The arrangement is part of a pension.
D. The arrangement is part of a post-retirement benefit plan.

4. According to Russ Madray, which of the following is ***not*** a benefit of a non-qualified plan?

A. No non-discrimination rules.
B. Tax advantages.
C. Can provide a business with access to funds until the deferred compensation is due to participants.
D. No annual contribution limits.

5. According to Russ Madray, which of the following arrangements would ***not*** fall under the ASC 710 guidance?

A. Split-dollar life insurance that are in-substance deferred compensations.
B. Deferred compensation arrangements offered to an employee by individual contract.
C. Deferred compensation arrangements offered to an employee as part of a plan.
D. Employer's obligation for deferred compensation results from the employee's past service and the rights vest or accumulate, and the employer's payment is probable and estimable.

Continued on next page

6. According to Jennifer Louis, which of the following is ***not*** a synonym for ESG?

    A. Sustainability reporting.
    B. Environmental, social, and governance.
    C. Economic environment reporting.
    D. Corporate social responsibility reporting.

7. According to Jennifer Louis, which of the following is responsible for ensuring that fairly prepared financial statements include the appropriate ESG related matters?

    A. The external auditors.
    B. The internal auditors.
    C. Management.
    D. Regulators.

8. According to Jennifer Louis, which of the following is ***not*** a source of information an auditor could review in order to gain an understanding about issues such as climate related matters?

    A. Entity's sustainability report.
    B. Press releases from the entity.
    C. Industry regulatory averages.
    D. Entity budgets.

9. According to Jennifer Louis, which of the following is the auditor's responsibility for ESG related matters in other information included in annual reports?

    A. To read it and look for material inconsistencies between the annual report and the audited financial statements.
    B. To expand the audit procedures performed to address other matters.
    C. To make an assessment on the annual report based on information gleaned from the audit of the financial statements.
    D. To extend coverage of the opinion.

10. According to Jennifer Louis, which of the following is an issue that may impact fair presentation of tangible assets as it relates to ESG matters?

    A. Cash.
    B. Receivables.
    C. Prepaid assets.
    D. Inventory.

11. According to Kurt Oestriecher, the guidance on going concern is in which of the following ASC sections?

    A. ASC 105.
    B. ASC 205-40.
    C. ASC 210-30.
    D. ASC 235-25.

Continued on next page

12. According to Kurt Oestriecher, management must evaluate which of the following related to going concern?

    A. Known events only.
    B. Reasonably knowable events only.
    C. Reasonably knowable events where an estimate of impact on the financial statements can be determined.
    D. Known and reasonably knowable events.

13. According to Kurt Oestriecher, which of the following are factors that should be considered in making a going concern evaluation related to economic conditions?

    A. Changes in demographics.
    B. Changes in consumer habits.
    C. Changes in the stock market.
    D. Changes in accounting standards.

14. According to Kurt Oestriecher, which of the following are considerations to be made of management's plans in the face of a going concern situation?

    A. Likelihood of implementation and effectiveness.
    B. Likelihood customers will cooperate.
    C. Likelihood of implementation only.
    D. Likelihood other events will not occur causing additional going concern situations.

15. According to Kurt Oestriecher, when an entity moves to a liquidation basis of accounting, they will consult the guidance in which of the following ASC Topics?

    A. ASC 205-30.
    B. ASC 205-40.
    C. ASC 210-10.
    D. ASC 220-30.

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 2395 Midway Road, Carrollton, Texas 75006. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to **CPLgrading@thomsonreuters.com.**

How would you rate the topics covered in the July 2022 **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
Accounting for Deferred Compensation	|______|	|______|	|______|	|______|	|______|	|______|
AICPA ESG Practice Aid	|______|	|______|	|______|	|______|	|______|	|______|
Going Concern	|______|	|______|	|______|	|______|	|______|	|______|

Which segments of the July 2022 issue of **CPE Network® A&A Report** did you like the most, and why?

____

____

____

____

Which segments of the July 2022 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 July 2022 **CPE Network® A&A Report?** Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Russ Madray	|_____|	|_____|	|_____|
Jennifer Louis	|_____|	|_____|	|_____|
Kurt Oestriecher	|_____|	|_____|	|_____|

Which of the following methods would you use for viewing CPE Network® A&A Report? DVD ☐ Streaming ☐ Both ☐

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 audio/video program materials accurate and effective? 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: ____

____

Name/Company ____

Address ____

City/State/Zip ____

Email ____

Once Again, Thank You…

Your Input Can Have a Direct Influence on Future Issues!

CPE Network®

CPE Group Attendance Sheet

Firm/Company Name: ______________________

Account #: ______________________

Location: ______________________

Program Title: CPE Network Accounting and Auditing Report, July 2022 Date: __________

Name	Email	Total Hrs	IRS PTIN ID (if applicable Tax only)	Sign In	Sign Out

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	
Course Date:	
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 3 times per CPE hour. 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.

			First CPE Hour			CPE Hour 2			CPE Hour 3			FOR TR USE ONLY
First Name	**Last Name**	**Student Email**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Poll 1**	**Poll 2**	**Poll 3**	**Certificate Issued?**

CHECKPOINT LEARNING NETWORK

CPE NETWORK®
USER GUIDE

REVISED March 11, 2022

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 Thomson Reuters.

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

“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 either in print or online.

- If the print 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 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

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/

Requesting Participant CPE Certificates

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

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

Email: **CPLgrading@tr.com**

Fax: 888.286.9070

When sending your package to Thomson Reuters, 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 Thomson Reuters 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.

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 ask 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.

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 print 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 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

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 one of the following means:

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008
Email: **CPLgrading@tr.com**

Fax: 888.286.9070

When sending your package to Thomson Reuters, 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 Thomson Reuters 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—Print

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

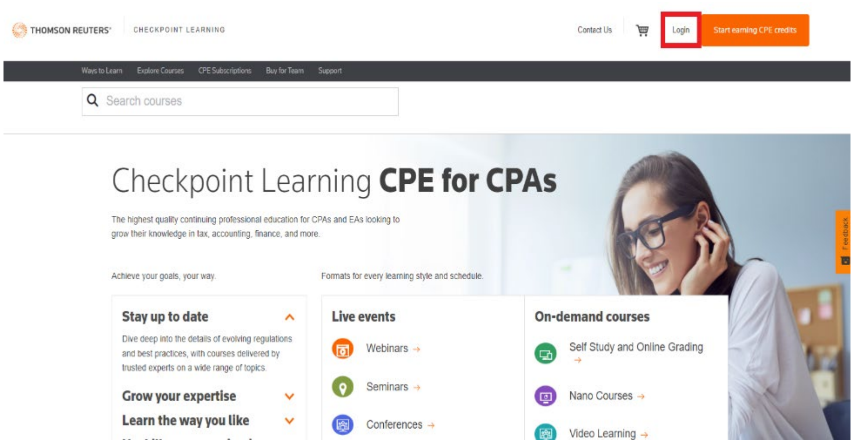
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

  Thomson Reuters
  PO Box 115008
  Carrollton, TX 75011-5008

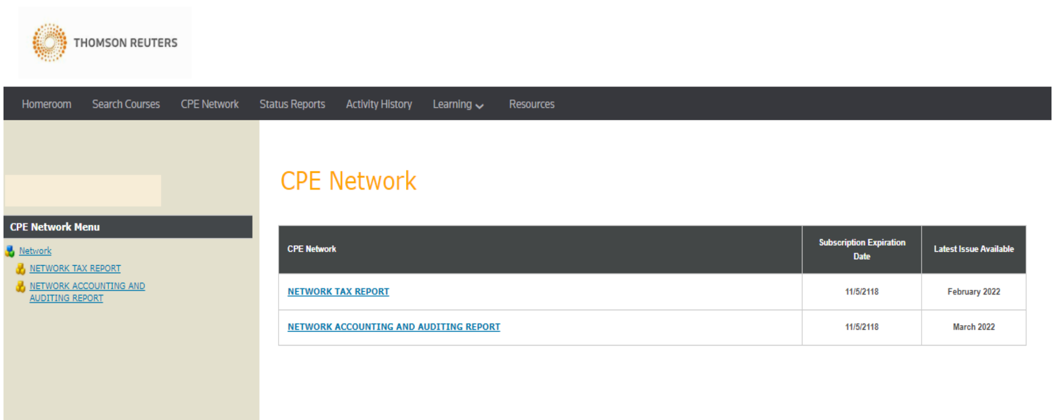
Self-Study—Online

Follow these simple steps to use the online program:

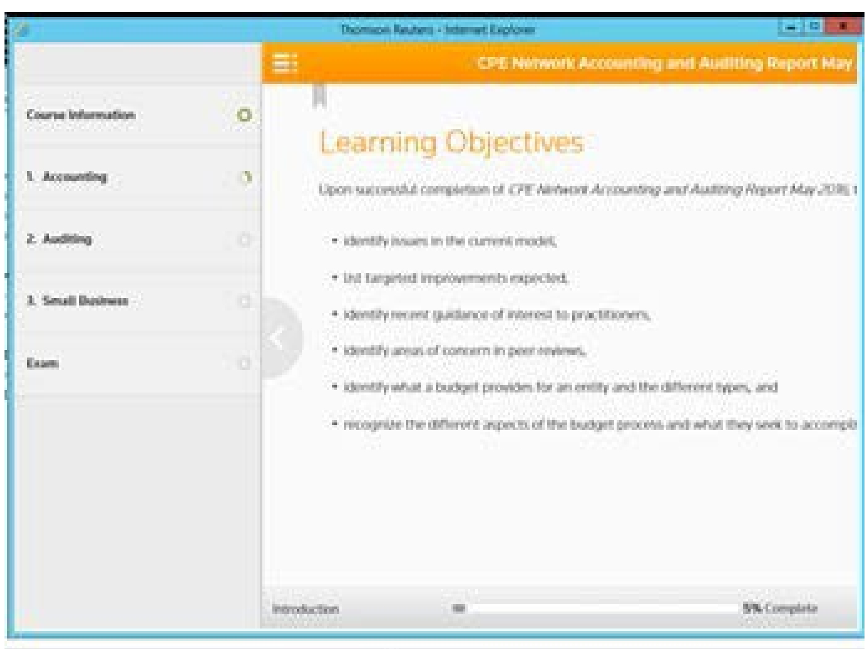
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm’s administrator in the upper right-hand margin (“Login or Register”).



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

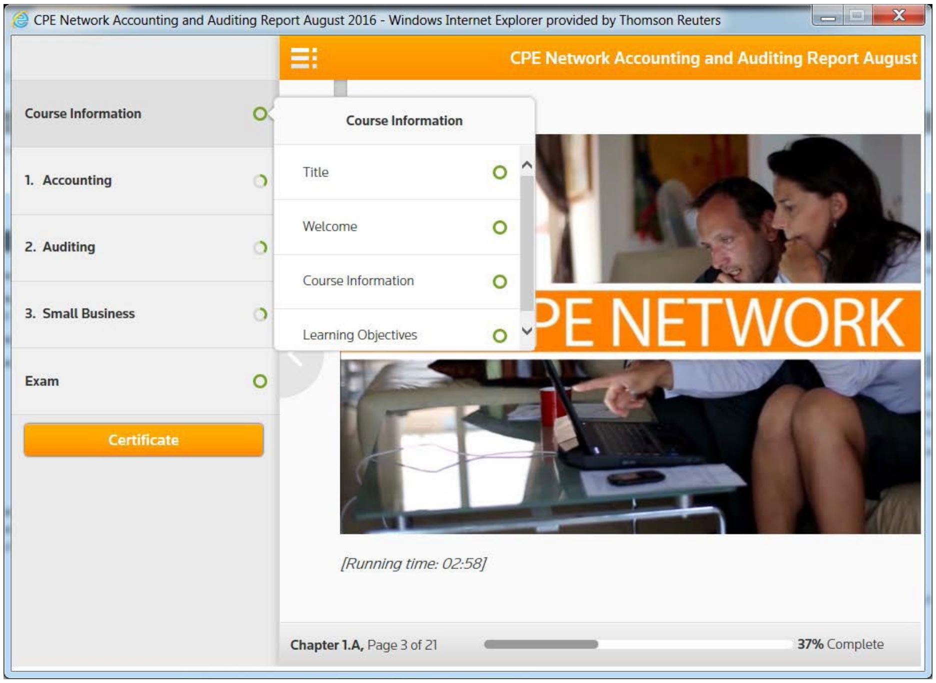


The Chapter Menu is in the gray bar at the left of your screen:

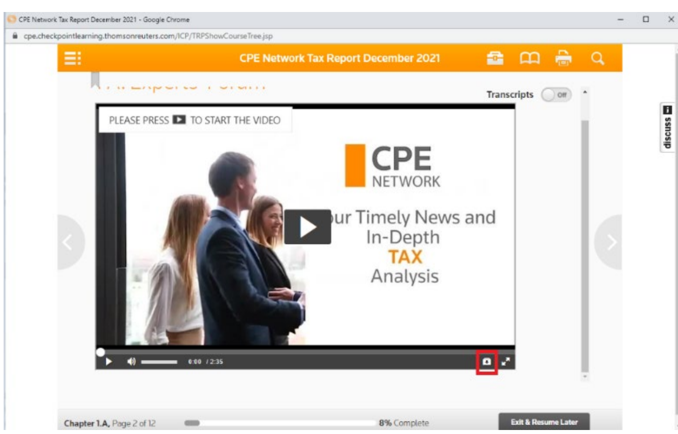


Click down to access the dropdown menu and move between the program Chapters.

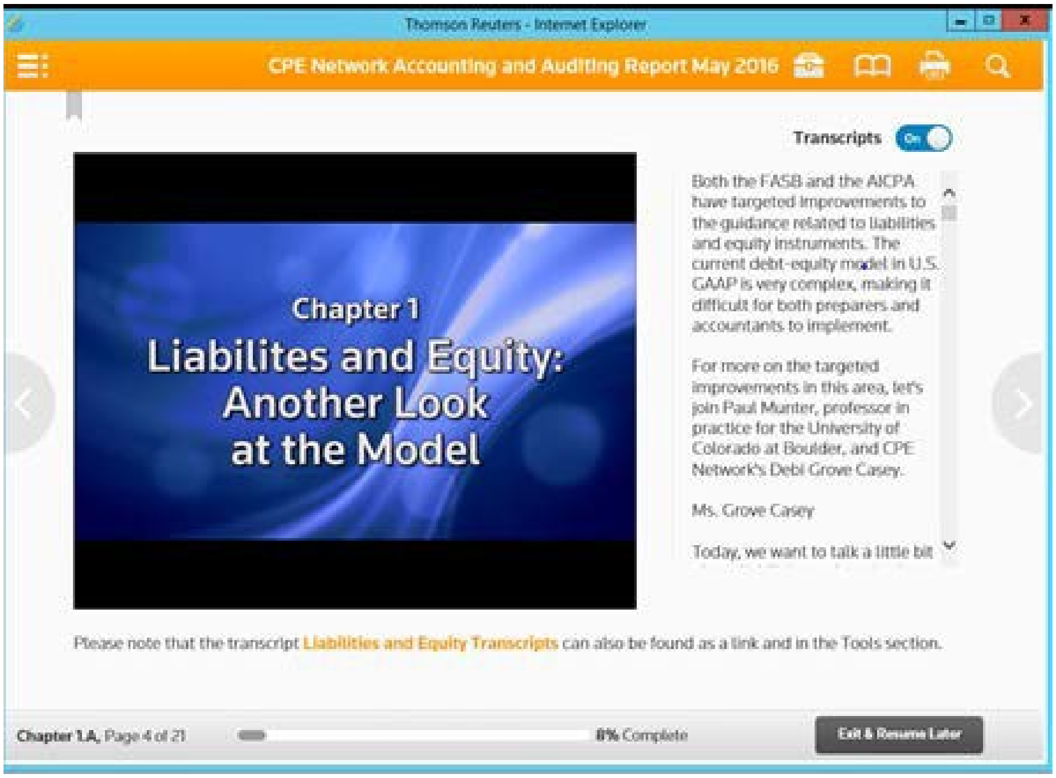
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



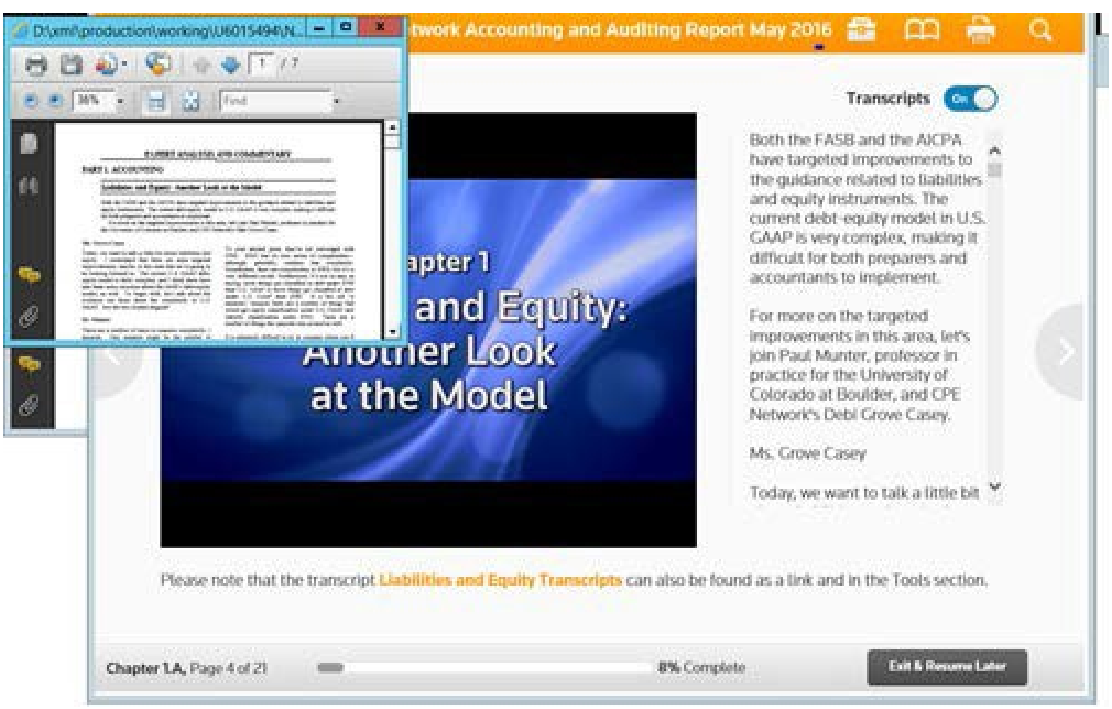
- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions. This more streamlined approach allows administrators and users to more easily access the related materials.



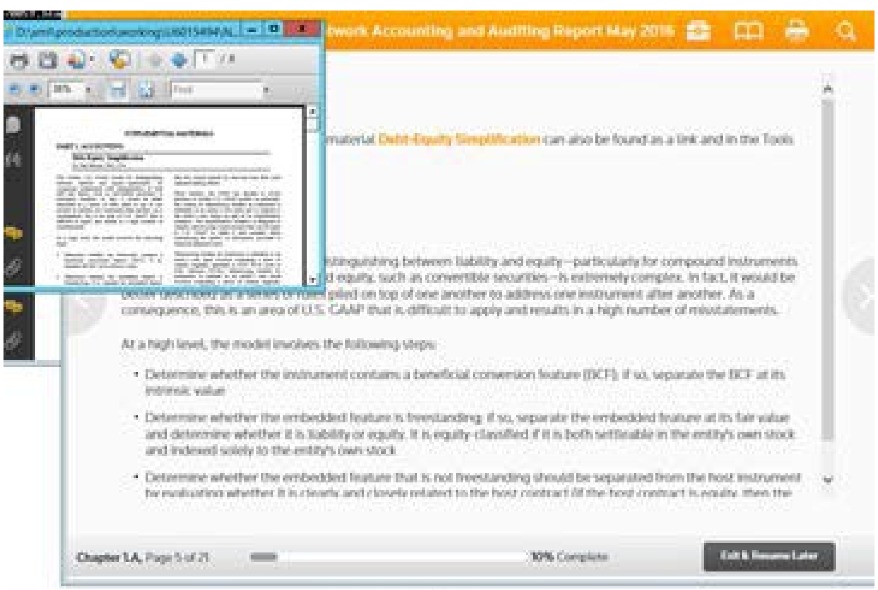
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.



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.

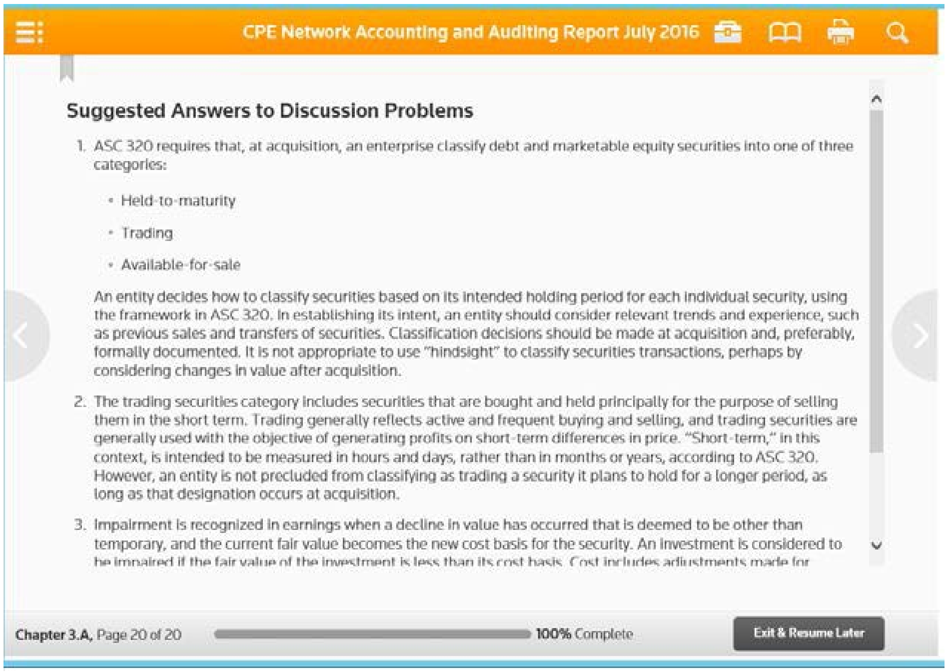


Click the arrow at the bottom of the video to play it, or click the arrow to the right side of the screen to advance to the supplemental material. As with the transcripts, the supplemental materials are also available via the toolbox and the link will pop up the pdf version in a separate window.



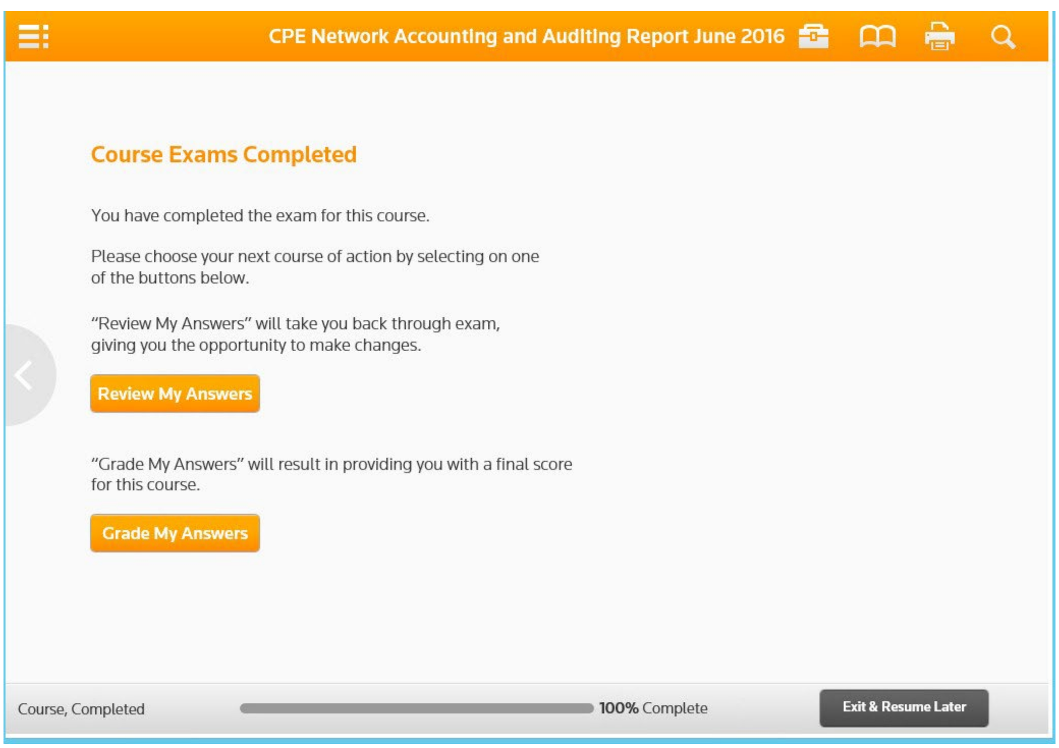
Continuing to click the arrow to the right side of the screen will bring the user to the Discussion p roblems related to the segment.

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



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.

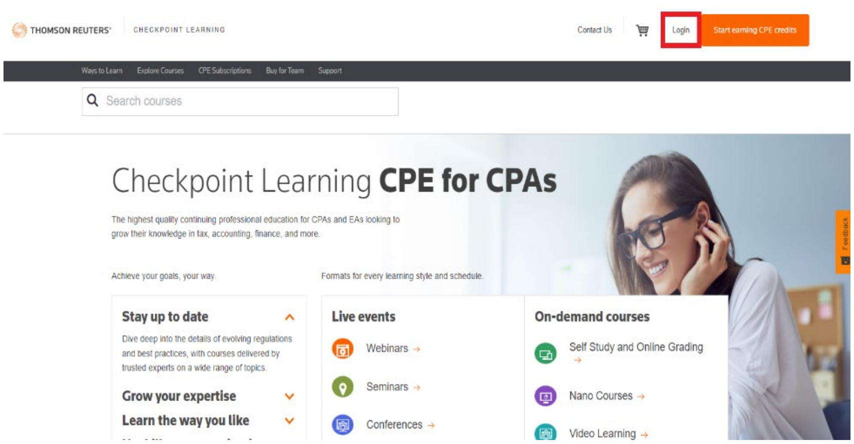
Print

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**.

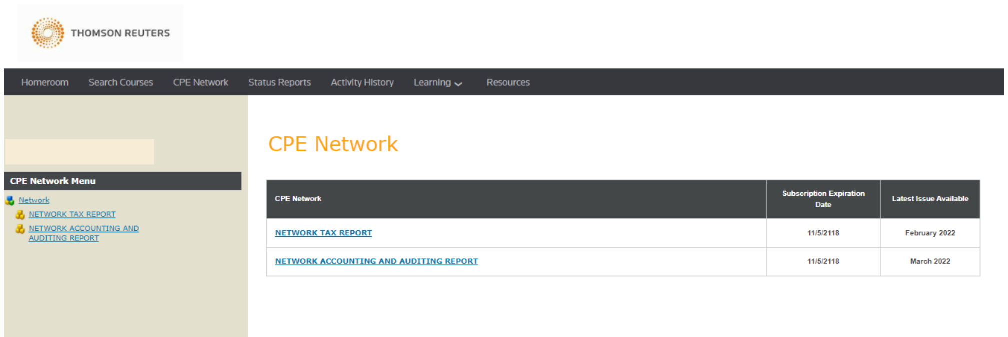
Transitioning From DVDs

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

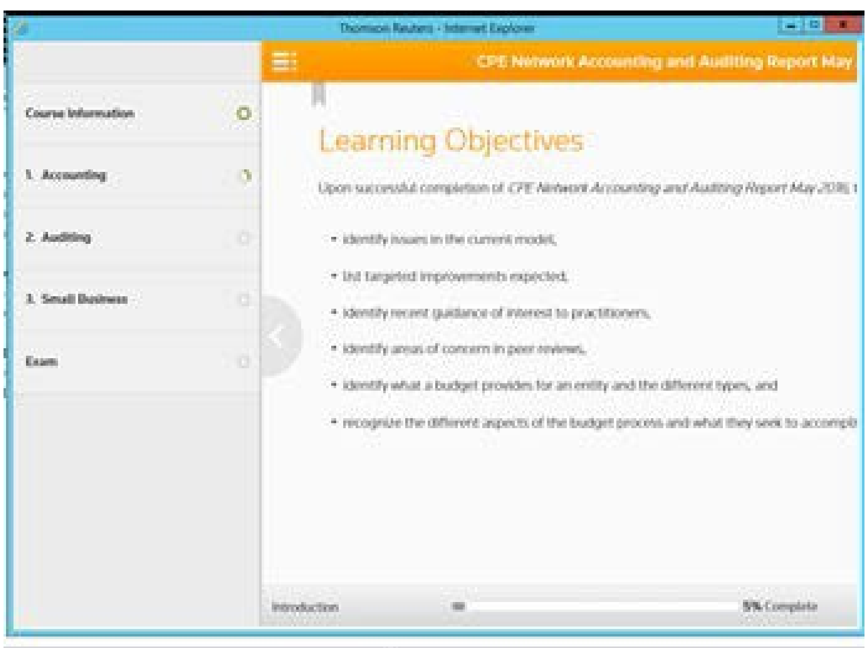
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



- 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:



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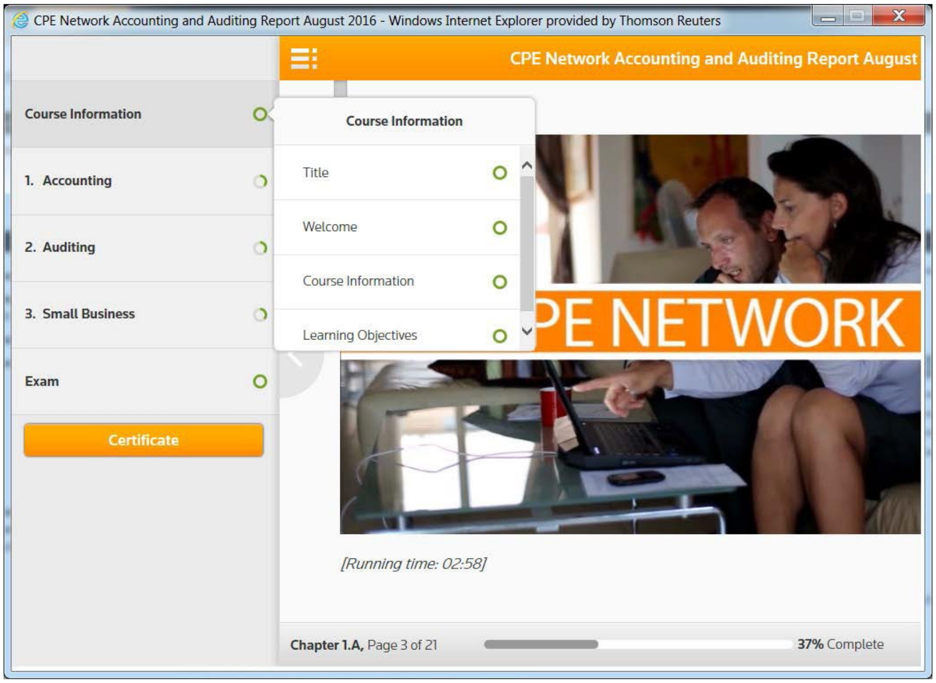
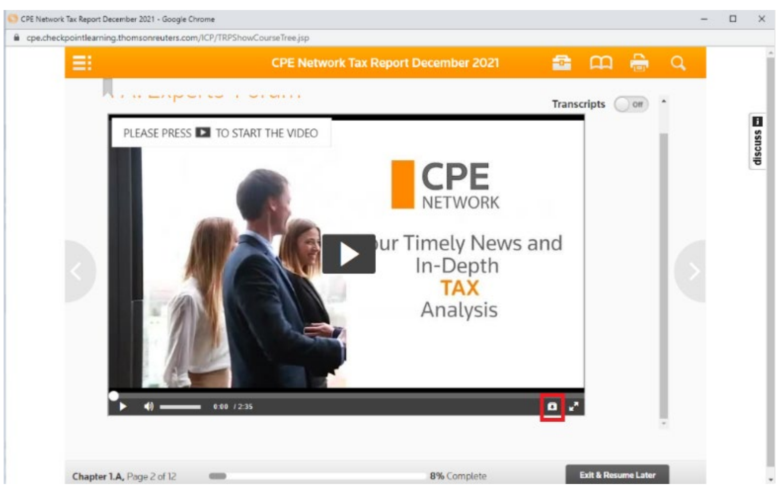


- Each Chapter is self-contained. Each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental materials, and then the discussion questions.



Video segments may be downloaded from the CPL player by clicking on the download button noted above. 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 by Checkpoint Learning CPE Customer Service.

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

<u>Determining CPE Credit Increments</u>

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.
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	800.431.9025 (follow option prompts	checkpointlearning.techsupport@ thomsonreuters.com	• Browser-based • Certificate discrepancies • Accessing courses • Migration questions • Feed issues
Product Support	800.431.9025 (follow option prompts	checkpointlearning.productsupport@ thomsonreuters.com	• Functionality (how to use, where to find) • Content questions • Login Assistance
Customer Support	800.431.9025 (follow option prompts	checkpointlearning.cpecustomerservice@ thomsonreuters.com	• Billing • Existing orders • Cancellations • Webinars • Certificates