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CPE NETWORK

ACCOUNTING & AUDITING REPORT

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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Accounting for Stock Appreciation Rights 3

Russ Madray, CPA reviews the accounting guidance for stock appreciation rights under U.S. GAAP.

[Running time: 33:25]

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

- Identify where the appropriate accounting guidance is located
- Identify the types of stock appreciation rights, how they are settled, and when they are profitable
- Identify which models are used for which types of awards

PART 2. AUDITING

Covid Related Frauds..... 19

Lee Ann Watters, CPA reviews federal programs that provided funds as part of Covid relief, and the areas where fraud has been identified. She also discusses controls and failures that have contributed to the issues.

[Running time: 55:30]

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

- Identify the period of time the ERC was available
- Identify the funding available under the ECIP
- Identify the amount of total covid-related fraud and the common types of fraud and red flags under the PPP loans
- Identify the elements of fraud
- Identify the components of internal control and where risk originates
- List breakdowns in controls related to the PPP loan program

ABOUT THE SPEAKERS

Lee Ann Watters, CPA, CGFM, CFE, is a Principal with MCM CPAs & Advisors, LLP. Ms. Watters has 30 years of experience performing governmental financial, compliance, and internal control audits. Previously, she served in the Cabinet for Human Resources, the Office of the Auditor of Public Accounts, and the office of the Attorney General for the Commonwealth of Kentucky. She is a former Regional Vice President for the Southeastern Region of the Association of Government Accountants (AGA), a past President of the Central Kentucky Chapter of the AGA, and currently serves on the Board of Directors of the Kentucky Society of Certified Public Accountants.

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.

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PART 1. ACCOUNTING

Accounting for Stock Appreciation Rights

Stock appreciation rights (SARs) are a type of employee compensation linked to the company's stock price during a predetermined period. When a stock has a price increase, employees holding them receive proceeds either in stock or cash. They are similar to employee stock options but employees don't have to buy stock in order to benefit from them.

For more on stock appreciation rights and how to account for them, 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 stock appreciation rights. Now, the accounting standards codification addresses an employer's accounting for a variety of compensation related issues, including stock appreciation rights. So to begin with, could you give us an overview of the guidance related to these types of awards?

Mr. Madray

Sure. You're exactly right. The ASC provides guidance on employee compensation in, essentially, four different major topics. As you see on this first slide, there's Topic 710, which is the compensation general topic; ASC 712, which is the non-retirement post-employment benefits; ASC 715 on retirement benefits, and then, ASC 718 on stock compensation. And that's where we're going to be focusing our discussion today. Stock appreciation rights or SARs are a type of employee compensation that are linked to the company's stock price during a predetermined period. SARs would be profitable for employees when the company's stock price rises, which makes them similar to employee stock options. The major difference though is employees don't have to pay the exercise price with stock appreciation rights. Rather they just receive the sum of the increase in either shares of stock or in cash.

The primary benefit of stock appreciation rights is that employees can receive proceeds from stock price increases without actually having to buy the stock. Some folks say stock appreciation rights are very similar to something called phantom stock. The difference is that phantom stocks typically are reflective of stock splits and dividends. Phantom stock is a promise an employee will receive either the value of the company shares or an amount that the stock price

increases during a specified period. The phantom stock bonus an employee receives is taxed as ordinary income when it's received by the employee. Phantom stock is not considered to be a tax qualified vehicle, so it would not have to follow the rules that employee stock ownership plans or 401K plans, for example, would need to follow. Stock appreciation rights offer the right to cash equivalent of stock price gains over a predetermined time interval.

In this case, employers almost always pay this type of bonus in cash. It is possible for a company to pay the employee bonus in shares but most often it's paid out in cash. In most cases employees can exercise stock appreciation rights after they vest. Sometimes employees will issue stock appreciation rights along with stock options. These are often referred to as tandem stock appreciation rights, and the purpose of doing that is they can assist in funding the purchase of the options and help pay off taxes that might be due at the time that the SARs are exercised. One side note here, the guidance on a topic that we've discussed before on Rabbi Trusts, the guidance in those sections of ASC 710, don't apply to stock appreciation rights.

Even if the employer funds those benefits through a Rabbi trust typically under a stock appreciation right plan the employee would eventually receive compensation equal to the increase in the fair value of a stated number of the employer's shares on a designated future date at the specified time, then the employee receives cash or an equivalent number of the employer's stock that represents that fair value increase. Although the employer that provides a stock appreciation right plan can segregate the contract in a rabbi trust, they would still account for the stock appreciation right plan under Topic 718, and not topic 710, which is where your typical rabbi trust deferred compensation guidance would be found. So that's kind

of a roadmap of where we go for the guidance for these types of plans.

Ms. Grove Casey

I'm assuming that a stock settled SAR, stock appreciation right, would be classified as equity, but what about a cash settled one?

Mr. Madray

Well, there's guidance in Topic 718 that provides some specific criteria for determining whether an award should be classified as a liability or as equity. A stock-settled SARS would be classified as equity, assuming it meets all the other requirements for equity classification. And it doesn't appear in this list that we're going to see in a moment. However, as I said, more often than not SARs are cash settled and therefore they're going to be classified as a liability. If you take a look at the next slide, you see there are some specific awards listed in Topic 718 that would be classified as liabilities, even if they are settled in stock. So you see an award with conditions or other features that are indexed to something other than a market performance or service condition.

So for example, an award that vests based on the appreciation in the price of a commodity or the company's shares an award that meets the criteria under a Topic 480 for classification as a liability would be classified that way. A share award that has a repurchase feature that permits an employee to avoid bearing the risks and rewards normally associated with equity ownership for a reasonable period of time by allowing the employee to put the shares to the company within six months after vesting in those shares. Also a share award where it's probable the employer would prevent the employee from bearing those risks and rewards normally associated with stock ownership within six months after share issuance. Also an option or similar instrument that could require the employer to pay an employee cash or other assets unless that cash settlement is based on a contingent event that is not probable and also is outside the control of the employee.

Now, important to note here as I said, most of these are cash settled, but if the plan offers a choice of settlement in stock or in cash, then the classification will depend on who makes that choice. If the employee can choose the form of settlement and they could potentially choose cash, the award would be classified as a

liability. If the employer, the company, has the choice of settlement, then technically it could avoid transferring assets by electing to issue stock. So in that case, as long as they have the ability to deliver the shares, that is, a sufficient number of authorized shares, the award would be classified as equity in that case. And then, finally, an option or a similar instrument where the underlying shares are classified as liabilities. So again, if the SARS will be equity settled typically they would be classified as equity and accounted for as such. Although you have to keep in mind these exceptions on the slide we just looked at. But in most cases, these are cash settled, therefore, they're going to be classified as a liability in most cases.

Ms. Grove Casey

Well, what about the actual accounting and the compensation expense? Could you explain how that's done with maybe some examples?

Mr. Madray

Sure. Well, Topic 718 requires that be valued at the fair value of the shares on the grant date. Although Topic 718 indicates that a fair value method is preferable in some cases, recall that non-public companies may have some options here because for a non-public company, it can be challenging to use a fair value method because of the difficulty of estimating volatility as one of the inputs in an option pricing model. And although non-public companies can look at volatility of similar public companies to help develop that volatility assumption if sufficient information is not available to estimate that expected volatility, non-public companies do have the ability to use a calculated value method as opposed to public companies non-public companies have to make an accounting policy election regarding whether to measure all liabilities incurred in share based compensation arrangements at fair value or intrinsic value.

For liability classified awards the measurement methods that are available depend on the method the company uses to measure its equity classified awards. A non-public company that uses fair value to measure its equity classified awards would need to adopt an accounting policy to measure all of its liability classified awards using fair value or an intrinsic value method. If a non-public company uses a calculated value method for its equity classified awards. They would make an accounting policy choice to measure all its liability classified awards using either that calculated

value method or the intrinsic value method. Now, under each of these measurement alternatives for liability classified awards, the company will have to remeasure the award on each reporting date using that same method until the award is settled. Now a little side note here that in October of 2021, the FASB did issue ASU 2021-07, which is determining the current price of an underlying share for equity classified share-based awards.

This ASU provides a practical expedient where a non-public company is allowed to determine the current price input of equity classified share-based awards issued to employees or non-employees using the reasonable application of a reasonable valuation method. The practical expedient in ASU 2021-07 can be elected for equity classified share-based awards within the scope of 718, including these stock appreciation rights that we're talking about here. Now that practical expedient is not available for liability classified awards. And to clarify that phrase, reasonable application of a reasonable valuation period is basically an income tax-based approach that is used for income tax reporting of these types of, of awards. But again, because more often than not these are cash settled, they're going to be liability classified anyway, so that wouldn't be available in those cases.

Let's talk a bit generally about how these are accounted for, and then, maybe we can take a look at a couple of examples. For stocks settled that are time vested, the fair value is determined using an option-pricing model. You know, a Black Scholes model or something of that nature compensation would then be accrued as expense over the SAR's service period, which is typically the vesting period. Any recognized compensation cost would not be reversed after that service had been rendered. Also, no previously recognized compensation cost would be reversed if the vested SAR expires unexercised. On the other hand, previously recognized compensation cost would be reversed if the SAR was forfeited due to the employee's failure to satisfy some type of service requirement. For stock settled where there's a performance condition, again, the fair value would be determined using an option pricing model. Thereafter, for each reporting period, the number expected to vest would be predetermined, and the grant date fair value of those SARs would be amortized over the remaining requisite service period. Then at the end of that service period, the compensation cost would be trued up to equal the fair value of the SARs that actually do vest. Once again, any previously recognized

compensation cost that did not vest would not be reversed. In that case then for stock settled where there's a market condition, the fair value would be determined using a Monte Carlo simulation or a binomial model, but not generally the Black Scholes model. That's because the Black Scholes model doesn't take into account that the award could be exercised before the expiration date.

In this case, compensation would then be accrued as expense over the SARs requisite service period. And then regardless of whether the market condition goals were achieved any recognized compensation costs would not be reversed after that requisite service period had been rendered. As a side note, performance or service conditions that affect vesting are not reflected in estimating a fair value of an award at the grant date, because those conditions are restrictions that stem from the forfeitability of the instruments to which the grantees have not yet earned that. On the other hand, the effect of a market condition is reflected in estimating the fair value of the award at the grant date, so that's generally the approach for equity settled SARs under those that are time vested, performance conditions or market conditions.

Now, if we look at cash settled SARs, let's start with those that are time vested. The fair value would be determined using an option pricing model. Again, like Black Scholes, compensation would then be accrued as expensed over the requisite service period. Because these awards would be considered to be a liability, the entity would need to periodically adjust the value of the liability and also adjust the compensation expense based on changes in the fair value of the stock. The periodic expense and the adjustment to the liability is calculated based on the fraction of the total compensation expense earned to date by the recipients, based on the elapsed fraction of the service period reduced by any amounts already expensed in prior periods. At the end of each reporting period after the requisite service period is completed the SARs fair value would continue to be remeasured each reporting period until settlement with any increase or decrease in the fair value being recognized as a compensation cost or as income. Upon settlement of the SAR the compensation cost would be trued up to equal the intrinsic value.

In other words, the spread on the date of settlement. Now, if we have performance conditions, again, for these cash settled SARs fair value would, again, be

determined using an option pricing model, then at the end of each reporting period, the number of SARs that are expected to vest would be redetermined. The fair value of those would be remeasured and amortized over the remaining requisite service period, less any amounts previously recognized. At the end of each reporting period after the requisite service period, the SARs fair value would continue to be remeasured until settlement with any increase or decrease running through compensation cost or income, and once again, at the time of settlement, the compensation cost is trued up to equal the amount of cash actually paid any previously recognized cost for SAR that did not vest would not be reversed in that case.

And then finally, with a market condition for SARs, they have a market condition, the fair value would be determined using a Monte Carlo simulation or a binomial model, but not Black Scholes for the same reason we mentioned earlier. At the end of each reporting period, the SARs fair value would be remeasured and amortized over the remaining requisite service period, less any amounts that have previously been recognized. At the end of each reporting period after the requisite service period is completed, the fair value would continue to be remeasured, any increase or decrease run through compensation cost or, or income, any previously recognized compensation cost for these SARs that did not vest would not be reversed. So there's a lot of different variations because of the different types of conditions that might be associated with these stock appreciation rights. What I want to do is go through a couple of examples. One, an equity classified award and one a liability classified award. But we won't go through all of the different types of conditions and illustrations, so a lot of them end up being the same.

Ms. Grove Casey

Sounds good,

Mr. Madray

That's a good plan. So if we look at the next slide this is an example of an equity based award. So if we assume on December 31st, 2022, ABC company issues 4,000 stock appreciation rights that upon exercise entitle the employees to receive compensation equal in value to the excess of the market price at the exercise over the share price at the grant date the SARs vest ratably each year until the end of 2026; they expire at the end of 2030. Fair value of the SARs estimated using an option pricing model, let's assume is \$25 per right at

December 31st, 2022. So on the grant date, there's no entry. We do calculate the total compensation expense, 25 per stock appreciation, right, times 4,000 for a hundred thousand dollars to be recognized over that service period. Then at the end of those four years, we would make an entry to record stock based compensation expense of 25,000 and paid in capital for the stock appreciation right plan in that same amount of 25,000.

Now, if on the other hand, the employee will receive cash or can elect to receive cash, the award would be classified as a liability. And when a stock appreciation right is classified as a liability, termination of the fair value at the grant date, recognition of the compensation expense is going to be consistent with what we just saw with the equity classified award. But again, because these are considered to be a liability, the entity will have to periodically adjust the value of the liability and adjust the corresponding compensation expense based on the changes in the fair value of the SAR. Once again, the calculation is based on the fraction of the total compensation expense earned to date by the recipients based on the elapsed fraction of the service period reduced by any amounts already expensed in prior periods.

So if we look at the next slide, this will be a liability classified award. So assume again, December 31st, 2022, ABC Company issues 4,000 SARs that upon exercise entitle the employees to receive compensation equal in value to the excess of the market price at exercise over the share price at the grant date. They vest ratably each year until the end of 2026 and expire at the end of 2030. The employees may choose to receive cash at settlement. That's what makes this a liability classified award.

Let's assume the fair value of the SARs using an option pricing model at the grant date is \$25 per SAR so on the grant date, as you see on the next slide, there's no entry. We do calculate the total compensation expense at \$100,000. On December 31st, 2023, we would record an entry stock-based compensation expense \$25,000, and accrue the liability for the SAR plan in the same amount.

If we assume that one year later, the fair value of the SAR is \$27, we would record stock based compensation expense of \$29,000 at the end of 2024, and you see the calculation there. The current fair value of the SAR \$27 times the 4,000 SARs times the fraction

of the requisite service period that has elapsed (two over the four years) minus what's already been recognized in the previous year, gives us 29,000. If we assume a year later the fair value has increased to \$28, we would have an entry as we see here, stock based compensation expense would be debited for \$30,000 calculated as you see on the slide, \$28 times the 4,000 times three out of four years, minus what was expensed in the prior two years, 25 and 29. That gives us 30,000.

If we assume on December 31st, 2026, the fair value has dropped to \$23, then our stock-based compensation expense for that year would be \$8,000. And we see the 23 times the 4,000 SARs times the full service period four over four minus what has previously been expensed is where we get our 8,000. Then after that, we would make an entry to settle the SARs. And that's assuming all the employees choose cash settlement under this plan where we would debit the liability at its current balance of 92,000 and pay out the cash in that same amount.

Ms. Grove Casey

Well, usually when you have complex transactions, there are lengthy disclosures because there's a lot to talk about. So I assume that there are a lot of disclosure requirements related to these types of awards. Let's talk about what those are going to look like.

Mr. Madray

Yes. Any share-based payment plan in Topic 718 brings with it a lot of disclosure requirements. If we look at the next couple of slides, you'll see the types of things, and these are the minimum that would be required to be disclosed related to these plans. So first, a description of the share-based payment arrangement including the general terms of the awards, like the employee's requisite service period if applicable, any non-employee investing period, any other substantive conditions the maximum contractual term of equity or liability share options or similar instruments. The number of shares that are authorized for awards of equity share options and other equity instruments. We also have to disclose the method we use for measuring compensation costs from these arrangements. For the most recent year where we have an income statement, we have to include the number and weighted average exercise price or conversion ratios for these types of share options or share units; those outstanding at the beginning of the year, those outstanding end of the year, those exercisable or convertible at the end of the year,

as well as those that were granted exercise or converted, forfeited or expired during the year.

Also, the number and weighted average grant date, fair value, or if it's a non-public entity using calculated value or intrinsic value that would be disclosed for those equity instruments that are non-vested at the beginning of the year. Those non-vested at the end of the year, and those during the year that were granted, vested or forfeited for each year an income statement is provided, we have to disclose the weighted average grant date, fair value, or again, calculated or intrinsic value of equity options or other equity instruments that are granted during the year, as well as the total intrinsic value of the options at exercise. Share based liabilities paid and total fair value of the shares vested during the year, for those that are fully vested. And share options that are expected to vest as well as any unvested share options where the employees requisite service period or non-employees vesting periods have not been rendered, but that are expected to vest based on the achievement of a performance condition. At the date of the latest balance sheet, we have to include the weighted average exercise price or conversion ratio aggregate intrinsic value and weighted average remaining contractual term of the options outstanding, as well as the weighted average exercise price, aggregate intrinsic value, the weighted average remaining contractual terms of options that are currently exercisable. Further, for every year an income statement is presented, we have to include a description of the method that was used during the year to estimate the fair value or calculated value of the awards under share-based payment arrangements.

A description of the significant assumptions that are used during the year to estimate the fair value of the share-based compensation awards including the expected term of the share options including a discussion of the methods used to incorporate the contractual term of the instruments and the grantees expected exercise and post-vesting termination behavior into the fair value of the instrument; expected volatility of the entity shares and the method that's used to estimate that. Remember, the non-public entity that uses a calculated value method here will need to disclose the reasons why it's not practicable for it to estimate the estimated volatility for its share price. The reasons for selecting a particular industry index and how that calculated historical volatility was calculated using that index information about expected dividends, disclosure of the risk-free rates and disclosure of the

discount for post vesting restrictions and the method for estimating those discounts. Further, an entity that grants equity or liability instruments under multiple share-based payment arrangements needs to provide information separately for the types of awards to the extent that there are differences in the characteristics of the awards, and make separate disclosures important to understanding the entity's use of share based compensation. So for example, separate disclosure over the weighted average exercise price at the end of the year for options with a fixed exercise price and those with an indexed exercise price could be important. It might also be important to segregate the number of options that are not yet exercisable into those that will become exercisable based solely on fulfilling a service condition and those where a performance condition would need to be met to become exercisable. It might also be important to provide separate disclosures for awards that are classified as equity as opposed to those that are classified as liabilities. And, also entities that have multiple share based payment arrangements need to disclose information separately for different types of awards to the extent that differences in the characteristics make separate disclosure important to understanding their use of compensation. In those cases, every year an income statement is presented we have to include total compensation cost under the share-based payment arrangements that's recognized and in income as well as any that's capitalized as part of the cost of an asset. A description of modifications that may have occurred during the period as of the latest balance sheet date, the total compensation cost that's related to non-vested awards, not yet recognized as well as the weighted average period over which it's expected to be recognized. If it's not disclosed elsewhere, the amount of cash that's used to settle equity instruments granted under share-based payment arrangements. It has to be a description of the entity's policy for issuing shares upon share option exercise, including the source of those shares, for example, new shares or treasury shares.

If it's not disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur as a policy choice. And then, finally, if it's not disclosed elsewhere, the amount of cash it's received from exercise of share options, other estimates that are granted under share-based payment arrangements and the tax benefit from stock options that are exercised during that annual period. So that is a mouthful. As I said, anything under 718 is going to have a boatload of disclosure requirements. And stock appreciation rights,

stock options probably have about as much as any of the others, more than some of the other things we've discussed in the past, like the restricted stock awards and that kind of thing. So just a ton of things that have to be in the notes related to these types of awards.

Ms. Grove Casey

So basically, they should be prepared to write a small pamphlet, maybe a short book, if they have those kinds of arrangements.

Mr. Madray

A short novel. Yes.

Accounting for Stock Appreciation Rights

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*

Stock appreciation rights (SARs) are a type of employee compensation linked to the company's stock price during a predetermined period. SARs are profitable for employees when the company's stock price rises, which makes them similar to employee stock options (ESOs). However, employees do not have to pay the exercise price with SARs. Instead, they receive the sum of the increase in stock or cash. The primary benefit of stock appreciation rights is that employees can receive proceeds from stock price increases without having to buy stock.

SARs are similar in some ways to phantom stock. The major difference is that phantom stocks typically are reflective of stock splits and dividends. Phantom stock is a promise that an employee will receive either the value of the company's shares or the amount that the stock price increases during a specified period. The phantom stock bonus an employee receives is taxed as ordinary income at the time it is received. Phantom stock is not tax-qualified, so it does not have to follow the rules that employee stock ownership plans (ESOPs) and 401(k)s must follow.

Stock appreciation rights offer the right to the cash equivalent of a stock's price gains over a predetermined time interval. Employers almost always pay this type of bonus in cash. However, the company may pay the employee bonus in shares. In most cases, employees

can exercise SARs after they vest. Employers sometimes issue SARs along with stock options. These stock appreciation rights are called tandem SARs. They assist in funding the purchase of options and help pay off taxes due at the time the SARs are exercised.

Observation: The Deferred Compensation—Rabbi Trust Subsections in FASB ASC 710-10 do not apply to stock appreciation rights, even if an employer funds these benefits through a rabbi trust. Typically, under a stock appreciation rights plan, an employee eventually receives compensation equal to the increase in the fair value of a stated number of the employer's shares on a designated future date. At the specified time, the employee receives cash or an equivalent amount of the employer's stock that represents the fair value increase. Although an employer that provides a stock appreciation rights plan may segregate the contract in a rabbi trust, the employer still accounts for the stock appreciation rights plan under FASB ASC 718.

Classification of SARs

FASB ASC 718-10-25-6 through 718-10-25-18 provides the criteria for determining whether an award should be classified as a liability or as equity. A stock-settled SAR would be classified as equity (assuming the award meets all other requirements for equity classification). The more common cash-settled SAR would be classified as a liability. Further, the following types of awards would be classified as liabilities:

- An award with conditions or other features that are indexed to something other than a market, performance, or service condition (e.g., an award that vests based on the appreciation in the price of a commodity and the company's shares)
- An award that meets certain criteria of FASB ASC 480, *Distinguishing Liabilities from Equity*
- A share award with a repurchase feature that permits an employee to avoid bearing the risks and rewards normally associated with equity ownership for a reasonable period of time by allowing the employee to put shares to the company within six months after the employee vests in the shares

- A share award where it is probable that the employer would prevent the employee from bearing the risks and rewards normally associated with stock ownership within six months after share issuance
- An option or similar instrument that could require the employer to pay an employee cash or other assets, unless cash settlement is based on a contingent event that is not probable and outside the control of the employee

Observation: If a SAR offers a choice of settlement in stock or in cash, the classification of the award depends on whether the employee or the company has the choice of the form of settlement. If the employee can choose the form of settlement and can potentially require the company to settle the award in cash, the award should be classified as a liability. If the company has the choice of settlement, it can avoid transferring assets by electing to issue stock. In that case, as long as the company has the ability to deliver shares (i.e., sufficient authorized shares) the award would be classified as equity.

- An option or similar instrument in which the underlying shares are classified as liabilities

Accounting for SARs

FASB ASC 718 requires that SARs be valued at the fair value of the shares on the date of grant. Although FASB ASC 718 indicates that the fair value method is preferable, in some cases, nonpublic companies may find it challenging to use the fair value method because of the difficulty of estimating volatility for use in an option pricing model. And, while nonpublic companies can look at volatility of similar public companies to help develop a volatility assumption, if sufficient information is not available to estimate expected volatility, nonpublic companies may use the calculated value method (although this is not commonly utilized given widely available volatility proxies). A nonpublic entity must make an accounting policy election regarding whether to measure all liabilities incurred in share-based compensation arrangements at fair value or intrinsic value. For liability-classified awards, the measurement methods available to a nonpublic company depend on the method the company uses to measure its equity-classified awards. A nonpublic company that uses fair value to measure its equity-classified awards should adopt an accounting policy to

measure all of its liability-classified awards using fair value or intrinsic value. A nonpublic company that uses a calculated value to measure its equity-classified awards would have an accounting policy choice to measure all of its liability-classified awards using the calculated value method or the intrinsic value method. Under each of the measurement alternatives for liability-classified awards, the company will remeasure the award on each reporting date using the same method until the award is settled.

Observation: In October 2021, FASB issued Accounting Standards Update (ASU) 2021-07, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards (A Consensus of the Private Company Council)*. ASU 2021-07 provides a practical expedient, whereby a nonpublic entity is allowed to determine the current price input of equity-classified share-based awards issued to both employees and nonemployees using the reasonable application of a reasonable valuation method. The practical expedient in ASU 2021-07 can be elected for equity-classified share-based awards within the scope of FASB ASC 718. The practical expedient is not available for liability-classified awards.

Stock-Settled SARs (Time-Vested)

For time-vested SARs, fair value is determined using an option pricing model (e.g., Black-Scholes or binomial model). Compensation is then accrued as expense over the SAR's requisite service period (e.g., typically the vesting period). Any recognized compensation cost may not be reversed after requisite service has been rendered. In addition, no previously recognized compensation cost may be reversed if a vested SAR expires unexercised. However, previously recognized compensation cost should be reversed if a SAR is forfeited due to employee's failure to satisfy a service requirement.

Stock-Settled SARs (Performance Condition)

For SARs with a performance condition, fair value is determined using an option pricing model (e.g., Black-Scholes or binomial model). Thereafter, for each reporting period, the number of SARs expected to vest is predetermined and the grant date fair value of these SARs is amortized over the remaining requisite period less amounts previously recognized. At the end of the

requisite service period, compensation cost is trued up to equal the fair value of the SARs that actually vest. Previously recognized compensation cost for SARs that did not vest would be reversed.

Stock-Settled SARs (Market Condition)

For SARs with a market condition, fair value may be determined using a Monte Carlo simulation or a binomial model but, generally, not Black-Scholes (since this model does not take into account that the award could be exercised before the expiration date). Compensation is then accrued as expense over the SAR's requisite service period. Regardless of whether the market condition goals have been achieved, any recognized compensation cost may not be reversed after the requisite service period has been rendered.

Observation: Performance or service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which grantees have not yet earned the right. However, the effect of a market condition is reflected in estimating the fair value of an award at the grant date.

Cash-Settled SARs (Time Vested)

For time-vested SARs, fair value is determined using an option pricing model (e.g., Black-Scholes or binomial model). Compensation is then accrued as expense over the SAR's requisite service period (e.g., typically the vesting period). Because these awards are considered to be a liability, the entity will need to periodically adjust the value of the liability (and the corresponding compensation expense), based on changes in the fair value of the stock. The periodic expense (and adjustment to the liability) is the fraction of the total compensation earned to date by recipients of the SARs (based on the elapsed fraction of the service period) reduced by an amount expensed in prior periods. At the end of each reporting period after the requisite service period is completed, the SAR's fair value would continue to be re-measured each reporting period until settlement and any increase/decrease in the fair value immediately would be recognized as a compensation cost or income. Upon settlement of the SAR, compensation cost is trued up to equal the SAR's intrinsic value (i.e., spread) on the date of settlement.

Cash-Settled SARs (Performance Condition)

For SARs with a performance condition, fair value is determined using an option pricing model (e.g., Black-Scholes or binomial model). Thereafter, at the end of each reporting period, the number of SARs that are expected to vest is re-determined and the fair value of these SARs would be re-measured and amortized over the remaining requisite period less amounts previously recognized. At the end of each reporting period after the requisite service period is completed, the SAR's fair value would continue to be re-measured until settlement and any increase/decrease in the fair value immediately would be recognized as a compensation cost or income. At time of settlement, compensation cost is trued up to equal the amount of cash actually paid. Previously recognized compensation cost for SARs that did not vest would be reversed.

Cash-Settled SARs (Market Condition)

For SARs with a market condition, fair value may be determined using a Monte Carlo simulation or a binomial model, but not Black-Scholes. At the end of each reporting period, the SAR's fair value is re-measured and amortized over the remaining requisite service period less amounts previously recognized. At the end of each reporting period after the requisite service period is completed, the SAR's fair value would continue to be re-measured until settlement and any increase/decrease in the fair value immediately would be recognized as a compensation cost or income. Previously recognized compensation cost for SARs that did not vest would be reversed.

The following examples illustrate the accounting for an equity-classified award (Example 1) and a liability-classified award (Example 2):

Example 1:

Assume that on December 31, 2022, ABC Company issued 4,000 SARs that, upon exercise, entitle employees to receive compensation equal in value to the excess of the market price at exercise over the share price at the grant date. The SARs vest ratably each year until the end of 2026 and expire at the end of 2030. The fair value of the SARs, estimated by an appropriate option pricing model, is \$25 per SAR at December 31, 2022.

12/31/22 No entry; calculate total compensation expense $\$25 \times 4,000 = \$100,000$ to be recognized over the requisite service period

On December 31, 2023 – 2026, the following entry would be recorded:

12/31/XX	Stock-based compensation expense	\$25,000
	Paid-in capital—SAR plan	\$25,000

If, on the other hand, the employee will receive or can elect to receive cash, the award would be classified as a liability. When a SAR is classified as a liability, determination of fair value at grant date and recognition of compensation expense over the service period is consistent with accounting for an equity-classified award. However, because these awards are considered to be a liability, the entity will need to periodically adjust the value of the liability (and the corresponding compensation expense), based on changes in the fair value of the SAR.

The periodic expense (and adjustment to the liability) is the fraction of the total compensation earned to date by recipients of the SAR (based on the elapsed fraction of the service period) reduced by an amount expensed in prior periods.

Example 2:

Assume that on December 31, 2022, ABC Company issued 4,000 SARs that, upon exercise, entitle employees to receive compensation equal in value to the excess of the market price at exercise over the share price at the grant date. The SARs vest ratably each year until the end of 2026 and expire at the end of 2030. The employees may choose to receive cash at settlement. The fair value of the SARs, estimated by an appropriate option pricing model, is \$25 per SAR at December 31, 2022.

12/31/22 No entry; calculate total compensation expense $\$25 \times 4,000 = \$100,000$

On December 31, 2023, the following entry would be recorded:

12/31/23	Stock-based compensation expense	\$25,000
	Liability—SAR plan	\$25,000

Assume that, on 12/31/24, the fair value of the SARs is \$27. The following entry would be recorded:

12/31/24	Stock-based compensation expense	\$29,000*
	Liability—SAR plan	\$29,000

* $(\$27 \times 4,000 \times 2/4) - \$25,000 = \$29,000$

Assume that, on 12/31/25, the fair value of the SARs is \$28. The following entry would be recorded:

12/31/25	Stock-based compensation expense	\$30,000*	
	Liability—SAR plan		\$30,000

$$* (\$28 \times 4,000 \times 3/4) - (\$25,000 + \$29,000) = \$30,000$$

Assume that, on 12/31/26, the fair value of the SARs is \$23. The following entry would be recorded:

12/31/26	Stock-based compensation expense	\$8,000*	
	Liability—SAR plan		\$8,000

$$* (\$23 \times 4,000 \times 4/4) - (\$25,000 + \$29,000 + \$30,000) = \$8,000$$

On December 31, 2026, the following entry would be recorded to settle the SARs (assuming all employees choose cash settlement):

12/31/26	Liability—SAR plan	\$92,000	
	Cash		\$92,000

Disclosures

FASB ASC 718-10-50-2 and 50-2A outline the “minimum information” an entity must disclose in its annual financial statements related to share-based payments. The following generally would be applicable to SARs plans:

- A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
 - The employee’s requisite service period(s) and, if applicable, the nonemployee’s vesting period and any other substantive conditions (including those related to vesting)
 - The maximum contractual term of equity (or liability) share options or similar instruments
 - The number of shares authorized for awards of equity share options or other equity instruments
- The method it uses for measuring compensation cost from share-based payment arrangements
- For the most recent year for which an income statement is provided, both of the following:
 - The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or share units):
 - Those outstanding at the beginning of the year
 - Those outstanding at the end of the year
 - Those exercisable or convertible at the end of the year
 - Those that during the year were:
 - Granted
 - Exercised or converted
 - Forfeited
 - Expired
 - The number and weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured pursuant to FASB ASC 718-10-30-21) for all of the following groups of equity instruments:

- Those nonvested at the beginning of the year
- Those nonvested at the end of the year
- Those that during the year were:
 - Granted
 - Vested
 - Forfeited
- For each year for which an income statement is provided, both of the following:
 - The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value) of equity options or other equity instruments granted during the year
 - The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year
- For fully vested share options (or share units) and share options expected to vest (or unvested share options for which the employee's requisite service period or the nonemployee's vesting period has not been rendered but that are expected to vest based on the achievement of a performance condition, if an entity accounts for forfeitures when they occur) at the date of the latest statement of financial position, both of the following:
 - The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) outstanding
 - The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible)
- For each year for which an income statement is presented, both of the following (an entity that uses the intrinsic value method is not required to disclose the following information for awards accounted for under that method):
 - A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements
 - A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):
 - Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instruments and grantees' expected exercise and post-vesting termination behavior into the fair value (or calculated value) of the instrument
 - Expected volatility of the entity's shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. A nonpublic entity that uses the calculated value method shall disclose the reasons why it is not practicable for it to estimate the expected volatility of its share price, the appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index
 - Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends
 - Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used
 - Discount for post-vesting restrictions and the method for estimating it

- An entity that grants equity or liability instruments under multiple share-based payment arrangements shall provide the information separately for different types of awards (including nonemployee versus employee) to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a service condition and those for which a performance condition must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation
- For each year for which an income statement is presented, both of the following:
 - Total compensation cost for share-based payment arrangements
 - Recognized in income as well as the total recognized tax benefit related thereto
 - Capitalized as part of the cost of an asset
 - A description of significant modifications, including:
 - The terms of the modifications
 - The number of grantees affected
 - The total (or lack of) incremental compensation cost resulting from the modifications
- As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized
- If not separately disclosed elsewhere, the amount of cash used to settle equity instruments granted under share-based payment arrangements
- A description of the entity's policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period
- If not separately disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur
- If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit from stock options exercised during the annual period

The following is an example of these disclosure requirements from AZZ Incorporated:

Stock Appreciation Rights and Option Awards

Stock appreciation rights and option awards are granted with an exercise price equal to the market value of our common stock on the date of grant. These awards generally have a contractual term of 7 years and vest ratably over a period of three years although some may vest immediately on issuance. These awards are valued using the Black-Scholes option pricing model.

A summary of the Company's stock appreciation rights and option awards activity for the three-month period ended May 31, 2012 is as follows:

	Options/SAR's	Weighted Average Exercise Price
Outstanding as of February 29, 2012	573,000	\$ 15.46
Granted	116,114	25.67
Exercised	(109,000)	12.23
Forfeited	—	—
Outstanding at end of the period ended May 31, 2012	580,114	\$ 18.11
Exercisable at end of period ended May 31, 2012	258,104	\$ 14.21
Weighted average fair value of options and SARs granted during the period ended May 31, 2012		8.79

The average remaining contractual term for those options/stock appreciation rights outstanding at May 31, 2012, is 5.24 years, with an aggregate intrinsic value of \$5.1 million. The average remaining contractual terms for those options/stock appreciation rights that are exercisable as of May 31, 2012 is 4.51 years, with an aggregate intrinsic value of \$3.3 million.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Describe how a SAR is classified (liability or equity) if it offers a choice of settlement in stock or in cash.
2. Discuss the practical expedient provided in ASU 2021-07, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Based Awards (A Consensus of the Private Company Council)*.
3. Explain the recognition and measurement of a SAR when it is classified as a liability.

B. Suggested Answers to Discussion Problems

1. If a SAR offers a choice of settlement in stock or in cash, the classification of the award depends on whether the employee or the company has the choice of the form of settlement. If the employee can choose the form of settlement and can potentially require the company to settle the award in cash, the award should be classified as a liability. If the company has the choice of settlement, it can avoid transferring assets by electing to issue stock. In that case, as long as the company has the ability to deliver shares (i.e., sufficient authorized shares) the award would be classified as equity.
2. ASU 2021-07 provides a practical expedient, whereby a nonpublic entity is allowed to determine the current price input of equity-classified share-based awards issued to both employees and nonemployees using the reasonable application of a reasonable valuation method. The practical expedient in ASU 2021-07 can be elected for equity-classified share-based awards within the scope of FASB ASC 718. The practical expedient is not available for liability-classified awards.
3. When a SAR is classified as a liability, determination of fair value at grant date and recognition of compensation expense over the service period is consistent with accounting for an equity-classified award. However, because these awards are considered to be a liability, the entity will need to periodically adjust the value of the liability (and the corresponding compensation expense), based on changes in the fair value of the SAR. The periodic expense (and adjustment to the liability) is the fraction of the total compensation earned to date by recipients of the SAR (based on the elapsed fraction of the service period) reduced by an amount expensed in prior periods.

PART 2. AUDITING

Covid Related Frauds

When Covid shut the world down in 2020, business was not usual for anyone. Some businesses were busier than ever, while some had difficulty retaining people, and others, shut by government order, moved to entirely new business models. In March 2020, the CARES Act was passed in response to the COVID-19 crisis. As part of that legislation, funds were quickly disbursed by the government to both individuals and entities in unprecedented amounts. Systems weren't always in place to manage the funds effectively or even to track who received what. Any time there is a lack of controls over funds, the situation becomes ripe for fraud to occur.

This month we have a special focus related to Covid-related fraud. For a look at where and how it has been occurring, let's join Lee Ann Watters, CPA, CFGM, a principal with Mountjoy, Chilton, and Medley, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk a little bit about Covid and some of the things that it's done to us in the last two or three years. It's certainly shaped our world for the last three years. The U.S. federal government responded in several ways to assist constituents financially. And, as a result of those payments, whole new fraud schemes were unleashed. One report that I read indicated that the Federal Trade Commission logged over 750,000 consumer complaints since the start of the pandemic, and the majority of them relate to identity theft. But it isn't just individuals that are being targeted, it's small businesses as well.

We, as accountants and CPAs, have a really unique role as trusted advisors, whether it's helping a business get that extra funding that may be available to them, like shuttered venue type stuff, or just getting a PPP loan kind of thing. While many times we may become aware of transactions or events as part of a tax engagement, for those that are not IRS related, the Office of the Inspector General at the Department of the Treasury is the appropriate place to report when you have an issue. So when I look at the Department of Treasury's page related to COVID-19 relief, I see four different sections of assistance. There's assistance for families and workers, small businesses, state and local governments, and then industry. Now, our focus here is going to be on small businesses. But to begin with, could you briefly recap the Covid support assistance for small businesses?

Ms. Watters

Sure. Why don't we start out talking about the employee retention credit? Or you may hear it called ERC first,

because in practice, this really seems to be an area where people have a lot of questions. This program was really applicable to payroll taxes that were paid in 2020. So for 2020, the ERC program provided a credit against certain payroll taxes, including the employer's share of social security taxes for wages that were paid between March the 12th of 2020, which was the date that we recognized the pandemic as a thing, and then year-end 12/31/2020. So the credit was 50% of wages that were paid up to \$10,000 per employee capped at 5,000 per employee. So it's kind of a quarterly thing. If the amount of the tax credit for an employee, an employer is more than what it paid, then they get the excess refunded directly to the employer.

If it's less, then it's just a credit and you pay in less. Does that make sense? Okay. So if for some reason your business is eligible for the ERC and you haven't claimed the credit, it's not too late. You can go back and you can file an amended payroll tax return for 2020 to claim the credit and receive that refund. And what we're seeing is just the other day, I had a client call me about this because they thought that they were just really nervous, I guess you would say about how all these programs worked with each other, and they had not claimed the ERC credit. And so now they wanted to go back and at least explore and see if they had any eligibility there. So to determine if you were eligible for the 2020 credit consider a couple things. One is whether or not your business was either fully or partially shut down during that period of time because of a government order that was related to the pandemic or if your business's gross receipts in any quarter in 2020, declined 50% or more relative to that same quarter for 2019.

So it can be one of those two reasons that you might have eligibility. Another thing that is important to remember is that the ERC is also available for all four quarters of 2021. So it was extended, the amount of the maximum tax credit was increased to \$7,000 per employee per quarter. And the level of qualifying business disruption was reduced to up to a 20% decline. . . in gross receipts during a single quarter. So that would make your business eligible. So the maximum benefit for the full year is \$28,000 per employee. So that can be very, very helpful. So if you're eligible and you haven't claimed the ERC, it's not too late. And I would encourage you to at least explore that option.

Before we move on to some of the other types of assistance that you wanted to take a look at I think it's important to look at the paid leave credit too. beginning and early 2020 businesses that had fewer than 500 employees were required to provide sick and family leave to employees who were dealing with the consequences of the virus. So that could be a real burden on a smaller business. And we saw people that were having, even though they weren't subject to a shutdown, they were still working, they were needing to take off because they were ill or because they were a caregiver for someone who was, or because they're a caregiver for a child or an adult who could not go to their normal school or adult day or something like that. So that is what this is related to. Under the law, businesses are entitled to a tax credit equal to 100% of the paid sick and family leave that was provided to employees.

I'm not going to get into all the rules that surround this, but just generally, businesses that paid employees under this program from April 1 of 2020 through the end of the tax year, 12/31/2020, can take that tax credit against their payroll taxes. And again, this is the same situation as with the ERC, if the amount of the credit is more than the employment tax then the excess is paid directly to the business, then the rescue plan, the American Rescue Plan, or ARPA as you hear it called frequently extended, the availability of the paid leave credits for small and midsize businesses through September of 2021. With this, businesses can take a dollar for dollar tax credit equal to, I guess it's up to \$5,000 if they paid leave to employees who were sick or quarantining and therefore unable to work. So as with the ERC, if you're eligible, I know I keep saying this, but I think it's important for people to take advantage of these programs. If you are eligible and you

haven't applied for that paid leave, you can file an amended return and receive your refund.

Ms. Grove Casey

Well, and so our clients may be getting calls from the third-party vendors that are, I don't want to say pulling this kind of number. So we may need to be proactive, particularly as we approach year end or that tax filing season where we would normally be talking to them anyway and say, If you haven't already looked at this yourself, when you come in, let's take a look at it. If we need to amend, we can still do that. We want to make sure that we're servicing you to the best of our ability.

Ms. Watters

And what I would tell you is a lot of CPA firms are partnering with one of those organizations that there is some concern because they usually get paid based on the amount of credit that you get. That the topic of our conversation today is covid-related fraud. So that's an incentive for fraud. So if someone approaches you, I think it's important that maybe you reach out to your accountant and ensure that is a reputable vendor for this particular service. If you work with the company that your accountant is maybe partnering with you know that entity has been vetted, because we as CPA firms don't want to link our reputation to someone who's not reputable.

Would you like to move on to the Emergency Capital Investment Program?

Ms. Grove Casey

Yes, let's talk about that.

Ms. Watters

Okay. We will move on to that. This program was created to encourage low and moderate income community financial institutions to expand their efforts to support small businesses and consumers in their communities. This program provided up to \$9 billion in capital directly to those depository institutions that are considered certified community development financial institutions (CDFIs) or minority depository institutions (MDIs) to provide loans, grants, and forbearance as well for small businesses, minority owned businesses and consumers. There is a lot of information by type of financial institution on Treasury's webpage about this program. So some real specific guidance that we don't necessarily have time to go into today but I would

encourage our viewers to look at that if they fit into one of those categories. We also have the paycheck protection program or the PPP loans. I feel like this is probably the one that people have heard the most about and they're most familiar with. Right? It kept a lot of us busy back in the first part of 2020.

This program was established by the CARES Act, and it provided small businesses with forgivable loans that would pay up to eight weeks of payroll cost, including benefits. The funds could also be used to pay interest on mortgages, rent, utilities, just some of the things that are necessary to keep businesses afloat when they're having and to keep employees retained when they're having reduced, reduced income. It was really aimed, you can tell by its name, that the whole aim at this program was job retention. So that's just a brief description of the program, but I know you're going to want to discuss that one more.

Ms. Grove Casey

Well, yes, I do want to discuss that a little bit more, but fraud is there. There's a variety of ways that let's say that the more free money there is, the more likely there is to be fraud somewhere in there because people are looking for whatever they can get or fraudsters should.

Ms. Watters

Exactly.

Ms. Grove Casey

So misappropriation of funds and illicit acquisition of funds related to these three areas are just now coming to light. The Justice Department has been very active in fraud enforcement related to COVID-19 relief. So let's talk a little bit about how frauds occur related to the program, some of which you just mentioned, the PPP loans, and then we had the EIDL, UI and then, healthcare fraud enforcement.

Ms. Watters

Sure. There's quite a bit there to unpack. So we know this pandemic was declared what, back middle of March of 2020, mid-March. The CARES Act was passed on March the 27th, 2020. That is lightning quick for the federal government

Ms. Grove Casey

Beyond lightning, I think. It occurred and boom legislation passed.

Ms. Watters

So we'll probably never see that again, and I hope I know we don't, right?

Ms. Grove Casey

We don't. I'm hoping not. The pandemic part anyway. Yes.

Ms. Watters

Exactly. But the related funding started rolling out quickly too. There was a lot of just, I think, pressure to get that money out into the economy. So because the purpose of the CARES Act was to provide this much needed interim assistance to bridge Americans and our economy through this early days of the pandemic, when we saw many venues being shuttered and people not working. So as you can imagine there wasn't a lot of guidelines that were provided at that time and it was just a flood of money and there was a flood of applicants. And sadly, as you alluded to, when you've got that situation going on, there are people who are going to take advantage of these programs for less than noble reasons. I saw a statistic that said it is estimated that total fraud of all covid-related funds is estimated to be somewhere around \$579 billion. That's a lot of money.

Ms. Grove Casey

It is a lot of money.

Ms. Watters

So why don't we start out by talking about the PPP loans if that's okay with you?

Ms. Grove Casey

That's great.

Ms. Watters

So I read an article that was published in April of 2022 that had an attention grabbing headline. And that headline was Biggest Fraud in a Generation, the Looting of the Covid Relief Plan, known as PPP. So apparently many borrowers inflated the number of employees that they had on hand. So they reported ghost employees. Some just even created companies that weren't previously in existence. I was listening you can bleep me if I'm not supposed to say this, but I was listening to an episode of the American Greed podcast about a week ago, and it was discussing someone who had done this. They were just churning out fictitious

companies and applying for PPP loans and then going forth and living lavishly. They weren't retaining any jobs because there weren't any jobs to retain. So anyway, back to this throughout 2020 lenders didn't do a whole lot to verify that the applications were legit because they were simply trying to get this money out so quickly and in the hands of people who needed them. So there've been several individuals like the one I just talked about, who have been prosecuted because it's been proven that they utilized the PPP loans for extravagant personal spending rather than retaining jobs. I don't know, maybe they can at least say they were contributing to the economy in some way.

Ms. Grove Casey

I don't know, maybe. But it really hurts as a taxpayer when you see it. I'm glad that they went after them so that they can make an example of that because that there are people who needed those funds and weren't able to get them as a result.

Ms. Watters

Because the funding did run out sometimes. Right?

Ms. Grove Casey

Yes.

Ms. Watters

Yes. It's sad. And I think it's sad to think that you have folks out there who are really that bereft of morals, but that's right.

Ms. Grove Casey

They think it's okay. Yes.

Ms. Watters

That's what we've got going on. We have that same type of issue with the Economic Injury Disaster Loan or the EIDL loans back at the end of July, 2020. So we're talking a three or so month span, The small Business administration's Office of the Inspector General or oig. published a document regarding concerns of potential fraud. And that particular program, as of that date, three months into this, the OIGs hotline had received complaints of more than 5,000 suspected fraud cases from financial institutions. I think that's a lot in three months.

Ms. Grove Casey

Well, when you extrapolate that out, yes, that's like 20,000 by the end of the year.

Ms. Watters

That's a lot.

Ms. Grove Casey

So well, for one program.

Ms. Watters

Well, yes.

Ms. Grove Casey

That's not the only program.

Ms. Watters

Exactly.

We didn't even discuss dollar amounts in there. . . I think we've all heard about the unemployment insurance fraud. I have a friend who works in unemployment insurance fraud here in the state of Kentucky. Every other state unemployment insurance office, they've just been overwhelmed with valid applicants who are seeking unemployment insurance due to the pandemic. But unfortunately, they also had a number of fraudsters who have been at it too. And it was difficult, I think, for them to take the time to fully vet all that because of the fact that they have thousands of people who were needing their unemployment insurance. The Washington Post had a really good article back in May of 2022 that said that identity theft and other sophisticated criminal schemes contributed to potentially \$163 billion in waste from this program. And it's not just the money they stole from taxpayers, but they also inflicted personal harm on just private citizens who were going about their business because basically these criminals stole the identification of real Americans, and then, bombarded states with applications filed in the name of actual workers, and sometimes even people who were in prison. Maryland reported that fraud. This is awful—Maryland reported that fraudulent claims actually outnumbered their valid applications. Think about that.

So I'll tell you a personal story with this. My mom is 74 years old. She is retired. She's part of the public pension system but she's not really the kind of gal that sits around at home. So she had two part-time jobs. Bookkeeping is what she does. So she was working at this little horse farm for a dear friend, and her job there was to process payroll. And so one day she's opening up the mail, and it's from Kentucky Department of

Unemployment Insurance, trying to verify her personal claim for unemployment insurance. And here she is—she's retired, first of all, and she's working two jobs. So I hooked her up with my friend at the Kentucky Unemployment Insurance Fraud Department. And my mom was just outraged. She's like, I'm retired and I have two jobs. So we got that one worked out. But there's an example if she had not been the person opening the mail there, she wouldn't have been aware that a claim had been made. So she's very concerned. She contacted a company that she uses to guard her personal identity. I'm on the board of our local chamber of commerce. We have three employees. We have over three employees who worked throughout the Pandemic. No loss of employment. And we had over 20 unemployment insurance claims for our three little employees. So I mean, that kind of tells you how prevalent this is.

Healthcare fraud enforcement remains a top priority for the U.S. Department of Justice. Again, with this particular issue, there were issues using relief funds for personal purchases as well as billing patients for services that did not occur, or for billing patients. For instance, if the funding provided X number of dollars, part of the requirement was that you would not try to go to the patient and receive more. So there were issues of this going on. So people are pretty creative.

Ms. Grove Casey

That's a nice way of putting that.

Ms. Watters

I would say if these people could use their creativity and their intelligence for good instead of stealing, we'd be in good shape.

Ms. Grove Casey

And it would probably be less work for them. Because you don't have to hide, right?

Ms. Watters

Exactly.

Ms. Grove Casey

So while to date, there's been a multitude of cases, only some of which are now coming to light and obviously losses in the hundreds of thousands, in some individual cases. There are a couple of different types that are common to PPP loan fraud. Typically, there's either

loan agent fraud or borrower fraud. And we mentioned that a little bit here a moment ago. But let's talk about what kinds of things we're seeing there and what indicators may exist, so that if other people are looking at it as we come across the financial statements, as I said, because we're getting close to that time of year where we see more of our clients on, let's say a regular basis, that if we notice it, we can do something about it.

Ms. Watters

Sure. Every business that I worked with personally worked directly with us and their financial institution to prepare the documentation that was required for the PPP loan application. But in many, many cases, prospective borrowers use the services of a loan agent to prepare their small business administration or their SBA loan application, and then, refer the borrower to a lender. This happens a lot of times when a potential lender doesn't have a relationship of that nature with the financial institution. And so the loan agent is trying to hook them up with someone who will provide them with these services. So they can be really helpful. A legitimate loan agent can be really helpful to borrowers that need help facilitating loan transactions. They're generally compensated based on a successful application. So there can be a temptation to submit fraudulent information on behalf of a borrower to help them get approved.

This can happen in any situation outside of the PPP loan environment. Just to be honest the SBA though, they have put out some really good resources that provide financial institutions with a list of red flags that they should be alert for when they're working with a loan agent, as well as some tips to protect themselves against corrupt loan agents. Some of those indicators include things like a lending agent being able to answer really difficult questions or resolve difficult issues just way too quickly. Something that you would really expect them to need to do a little research on and take some time before they get back to you, but they've got a really ready answer. If you have a situation where the loan agent is trying to control the communication between the financial institution and the borrower they won't let the financial institution speak directly to the borrower or vice versa. That can be a potential red flag, Right?

Because maybe that loan agent is communicating information that the borrower knows nothing about and that the borrower would say, No, that's not right. So that could be a loan agent or an issue. If the loan agent tries

to steer the lender to a specific appraiser or a specific title company, that could be a sign too, because they might have some kind of collusion relationship going on with those folks. And of course, if the loan agent is putting pressure on the lender to quickly close the loan, if they're saying, Hey, these people are going to lose their business if you don't do this, they're going to lay off 40 people. Those kind of things are all real issues. Real warning signs, I guess, of a potentially fraudulent loan agent. Now you also mentioned borrower fraud.

That really has more to do with the information that is submitted to obtain the loan rather than the misuse of the loan. So one person can do both things but they get that loan in the first place because they have provided false information to the lending institution during the loan application process. That can include providing false documents, failing to disclose liabilities and debts, overstating their income, failing to disclose a criminal record, failing to be honest about their citizenship status. You name it. There are many different things. I think probably the biggest red flag of this type of fraud is a credit report that doesn't support the same kind of information you're getting from a borrower, or if you can't get a credit report because it's fictitious. So that's something I think though, that in the kind of early days of this pandemic, there may have been some instances where the normal protocols of running those credit reports didn't happen.

Ms. Grove Casey

So when we talk about fraud, we usually discuss the triangle. So there's pressure, there's opportunity, and there's rationalization. But recently I've seen some other factors that were added to that, including capability and arrogance. And I always think of fraudsters at some point are either really stupid or they really are that arrogant that they don't think they're going to get caught. So let's talk about those a little bit.

Ms. Watters

I'm going to be honest with you, you're exactly right. I think there is some element of arrogance in every fraud scheme or in most fraud schemes. But when I started reading about this Fraud Pentagon, I got to be honest with you, it kind of left me speechless. It kind of makes you just shake your head and think, Oh, what an inflated opinion of yourself. But the competence piece that you talked about, it really expands on Donald Cressi's, who was the founder of the fraud triangle, his concept of the element of opportunity. So in conjunction with a

fraudster seeing that there's this opportunity, they've also got to have the individual ability to override the internal controls. They see that piece of it, but they also know that they can socially control this situation. They're smart enough to do it. They're socially adept enough to do it. They can, people, sell this to other people in some way. They can coerce even. Maybe they're a downright bully, who knows? And they can just get people to do what they want them to do or to turn a blind eye because it's just easier than dealing with that person. Generally, you will see these people actively try to surround themselves with people that they can control. I think that's interesting. But it's the arrogance piece that just really blows me away. Yes. I'm not going to lie to you. I think it's closely associated with a lack of conscience or an attitude of superiority and entitlement or greed on the part of a person who really believes that corporate policies and procedures and the rules of society, for lack of a better term, just really don't apply to them. They're above it all.

When I first read about this, and this goes back to your original point, I started looking at some of the famous fraud schemes or the ones you hear about a lot, and you could see that in fact, there is that element of arrogance in many of it in the long run. The people that just were kind of circumspect on their, I think the words you said was kind of stupid that those got found pretty early. Right?

Ms. Grove Casey

Yes. Well, generally they're not usually taking it for a different reason.

Ms. Watters

Exactly. Exactly. So I would really encourage our viewers to spend some time researching the Fraud Pentagon, if you haven't. It's really fascinating, even though it is disheartening because the cases that are cited are in every industry under the sun and in every size and type of business. And so what I think that brings us back to, you hear it said all the time, any business is susceptible to being a victim of fraud. Don't think it can't happen to you at your business.

Ms. Grove Casey

It's more a matter of when and not if.

Ms. Watters

Exactly. You're exactly right.

Ms. Grove Casey

So that brings us around to internal controls. And so even though the original COSO model for internal controls came out now like three decades ago somehow it's still relevant. And so their model with the five components even decades later, is really still relevant to both accounting firms and our clients, even though it's been a long time. So let's talk a little bit about what those components are just briefly.

Ms. Watters

Sure. So COSO or the Committee of Sponsoring Organizations was developed to help organizations of all types design and evaluate internal controls. And it has been tweaked along the way fairly recently. I can't remember the date really to take into consideration some IT issues that were not prevalent when it was originally issued. But even with that tweaking, it still focuses on those five integrated components of internal control with the first being the control environment. The control environment is really your standards or the structures that really provide the basis for internal control across an organization. This is really where you start. It drives everything. It's really related to senior management and those who are charged with governance and the tone that they set. You hear it called tone at the top that those folks set the tone regarding the importance of internal controls, standards of conduct ethics and integrity. We can all have just fantastic ethics policies, but if we act in a manner that is contrary to our written policy, the employees see that. And so you're not setting the tone at the top that is in line with the ethics policy. And what we know is people mirror what they see.

Ms. Grove Casey

Yes. So do what I say, don't do what I do.

Ms. Watters

Exactly. So that's control environment. Then the next kind of layer, I guess if you will, is the risk assessment. That is really the practice of critically analyzing your business, your processes, your procedures, and identifying the risks that prevent the achievement of your business goals, whether those be operational goals or financial accounting and reporting goals. I tend to think of it more from the financial accounting and reporting piece, just because that's my gig. And I think it's important to remember too, that risk can either be internal things that are going to happen within the walls

of your business. It can be external as well. So I think of this a lot with operational goals because manufacturers, they constantly have to think about their supply chain. So they need raw materials to manufacture. And so one of the risks to their operational goals might be at disruption to their supply chain. We've seen that recently, right?

Ms. Grove Casey

We've seen that a lot in the last few years. Right, exactly. Maybe people hadn't been examining that or assessing that risk as high as it really became, and it became, but they are now.

Ms. Watters

What do you think?

Ms. Grove Casey

Yes, I do.

Ms. Watters

Exactly. But they are now. And then the third level is the control activities. Those are the processes and procedures that you put in place to mitigate the risk that you identified back in the risk assessment stage. Those controls can be preventative or detective. So they're either going to prevent whatever that circumstance that brings the risk to your organization, or they're going to detect a problem when it occurs, and they're going to detect it soon enough that you can do something about it. So these controls are going to be present at all activities and all levels of your organization. And I think what you would say is typical forms of control activity include things like segregation of duties, verifications, and authorizations. When we're training new auditors to think about, to look at a processes and identify the ones that are controls, we tell them look for words like authorize or approve or review. Those are kind of the things that you're looking at that can tip you off that this is a good control, which is different necessarily from a process or a procedure. Okay. So moving on the four stages, information and communication. So think about this. You've got to have a way. You've done all this work, you've assessed your risk, you've designed your control activities, and you put it in a drawer. That won't work.

Ms. Grove Casey

That doesn't work very well.

Ms. Watters

It doesn't work very well. So you've got to have a way that you are routinely communicating and providing information to those who are internal to your organization, and those who are external to your organization as well. Your vendors, your customers, decision makers, and communication goes both ways. You've got to be able to receive communication from those folks as well as just give it. So for instance, if part of communication might be that you have some kind of reporting mechanism so that if people see something that is wrong, what happens a lot of times is, what do we call them? Unintended consequences. So you put some controls in place, and they're going along. They're going along but you didn't foresee this gap. You didn't see that changing this control was going to make a lack of segregation of duties issue. So there's got to be some mechanism for feedback so that employees can say, Hey, I know what you were trying to do, but let me tell you what happened exactly. Sorry, I like to talk too much about information and communication. No,

Ms. Grove Casey

And sometimes they have that. So maybe you're thinking that it's going to work in one direction, but maybe you have a change, and that change happens to be a personnel change of some sort, and it opens up new things that you weren't having to address before.

Ms. Watters

Exactly, and that is a good lead in to the fifth and final phase, which is monitoring. It's very important that organizations continue to monitor their internal control processes and verify what works and what doesn't. The reason being that for whatever reason, like you said, maybe it's because an employee has left and their position hasn't been filled, but people design these awesome policies and then they fail to monitor them. And over time, for whatever reason, they begin to degrade, and they're no longer effective for preventing and detecting anomalies, whether those anomalies be from error or fraud. Because I think that's important to remember. We are talking about fraud today, but there may be issues of unintentional error that pose a risk to your organization as well.

Ms. Grove Casey

So we've been talking about internal control components. So let's talk a little bit about where the

breakdowns in controls were that allowed for so many of those PPP loan frauds to have occurred.

Ms. Watters

So the small business administration's office of the Inspector General is really looking at this very critically, and they recently published a report that analyzed the way the small business administration handled the paycheck protection program loans. In this document, the OIG specifically identified some of the breakdowns. First, the OIG found that the organization structure didn't clearly define roles, responsibilities, and processes to really manage and handle potentially fraudulent PPP loans. There wasn't any kind of centralized entity to conduct a risk assessment and lead and manage that whole process. Part of this is because as we talked earlier, this assistance came out really quickly and there wasn't a good set of guidelines to go by.

Ms. Grove Casey

They were just in a hurry to get the money out.

Ms. Watters

Distributed. So that's one of the identified causes if you will, is that there wasn't sufficient, written guidance for handling potentially fraudulent loans. And that makes sense. We can understand it. It doesn't make it any less egregious, but we can understand the why. Secondly, the SBA didn't provide comprehensive fraud guidance to lenders. So that resulted in lenders not always really clearly understanding what to do if they suspected PPP loan fraud or how to recover funds that were obtained fraudulently from the PPP that remained in the borrower's account. This occurred because the SBA didn't provide lenders with specific sufficient guidance to enable them to effectively identify, track, and address, and then, ultimately resolve potentially fraudulent PPP loans. Apparently the reason this happened is because the SBA gave some general guidance like call the OIG hotline if you suspect there's a fraud. But the reason they didn't provide really specific guidance is because they believe that lenders already had industry regulations that would work for handling PPP loan fraud, and that was not the case. I mean, there was some guidance out there, but it didn't fit necessarily with the PPP loans.

Ms. Grove Casey

Were we seeing similar breakdowns in controls in our clients during covid?

Ms. Watters

So I think that organizations of all types did struggle to prevent the breakdowns in internal controls to some degree. What I saw in practice was that the more technologically advanced an entity was, the better they were able to adapt. So if they had invested in their IT infrastructure, they were in a much better position than an organization that did not. They were just better able to maintain the segregation of duties to make sure that they still had their review and their authorization processes going on. And they might be doing it in a slightly different way but it also wasn't terribly delayed. They were still able to do it, and it wasn't terribly delayed. I worked primarily with governments, as you know, and a few of them were still really, really paper centric.

Their mindset was, we all have to be in this building and they had great controls for being in the building. But those types of organizations really struggled to maintain their internal controls when they had to move to a remote environment. Most of my clients were able to do it. They did pretty good job because they're used to thinking about controls and segregation of duties. They're administering federal funds daily, so they know how important it is. But so what we saw were really, what I would say is delays in process and transactions. Just delays in their normal timeline because maybe I was in the office today and I initiated this transaction, but it's not your turn to come into the office for two days. And so two days later, I came in and you reviewed and approved it. So that was where I saw struggles.

I also saw a lot of struggles in the IT department, particularly with cybersecurity. They were set up well for their in-office networks, but when the need arose for people to be working remotely, they did not have robust controls around that particular function. They weren't ready to work on a VPN or in some kind of secure manner. So I think one good thing that I've seen come out of the pandemic is just a general upgrade and investment in IT at organizations that have traditionally kind of neglected that. They have a heightened awareness of cybersecurity issues and entities are really thinking critically about ways to enhance controls. Because even as we have all moved back into the workplace, to some degree, there's still a lot of remote working going on because people found they can do it. They can do it well. They can still be very efficient in doing so.

Ms. Grove Casey

Yes, I think, the thing is that if you haven't already, I mean it really helped that I'm sure that your clients had that control mindset in place. So we know that we need to have controls. It's about making it work. Obviously, it's a lot faster if you're moving to a remote environment, if you've already given that thought. I don't want to say it was kind of sprung on them, but it was kind of sprung on them. So then you're trying to do it under the gun and that makes it a little bit more difficult.

Ms. Watters

It did. I have one client just to be honest, their system was still one of the old DOS based systems. When their new finance director walked in and saw it, he didn't even know what it was because he had never worked in a DOS based system. Wow. Before, there was no working remote with that. So they had to find a way to struggle. One of the things that they're doing post pandemic is they are putting in a new system that is a lot more friendly to that type of environment.

Ms. Grove Casey

So what kinds of controls could be used even by smaller entities to prevent fraud? We often talk about segregation of duties, and even for a three person office, you can really make segregation of duties work. You just have to think about it a little harder.

Ms. Watters

You do. You're exactly right. Smaller entities, they really do struggle. And sometimes it's just not practical for them to fully segregate duties. You know, have to weigh the cost and the benefit. Right. And so what we find is that sometimes smaller entities do have to assume some level of risk related to lack of segregation of duties, but as you said, there are some controls that smaller organizations can put in place. Certainly, they need to conduct a risk assessment and identify what those are, and then, design some practical controls to address those risks. Maybe they'll need somebody to help them out in doing that. But one thing that is good that would be a really good control is in a small business is that a business owner can review bank statements and reconciliations and invoices prior to signing checks. I can't tell you how many times I've worked with people who said, I don't know, I just signed checks. They put a stack in front of me and I just go through and sign them. Terrible practice. I just want

to go on record as saying it. Probably most of our audience is agreeing with me,

Ms. Grove Casey

Hopefully.

Ms. Watters

I had a client so, well, she wasn't a client of mine. This was back in another job. I worked for the Kentucky Office of the Attorney General and we had received a referral case, and I've probably talked with you about this before, but this case had come to us from a local sheriff's office who did not have the expertise to handle this complaint. But it was a medical supply company, who had found out that, I think her title was office manager, but she actually was also their kind of bookkeeper/accountant. She paid their taxes, did their payroll, the whole nine yards but she just did whatever she wanted with absolutely no oversight. And had the owner been reviewing the invoices prior to signing checks, they probably would've noticed another thing. The business owner should always review the monthly credit card statements and see if those make sense or the charges that are on them. First of all, you should require that there be vendor invoices or receipts attached to those, but scan through them and make sure that that's a normal, legitimate vendor that you would be buying from. One of the things I saw was at this medical supply company was, Do you remember the health rider? It was this combination stair climber exercise bike, and this office manager person had used the businesses credit card to buy a health rider. Probably a business owner would've scanned through there and said, this is not a normal business expense for us and I don't see a health rider here. So that's a really easy example. I think sometimes too small businesses may ask an outside party to perform some of these reviews. I work with a lot of small governments and a lot of small not-for-profit organizations, and there are cases where they'll have a board of directors member kind of help out with some of these review procedures and review the bank reconciliation and sign off on it. Additionally, if it is practical and not cost prohibitive, an organization can consider outsourcing some functions like IT or payroll or possibly even accounting. So those are some things you can do.

Ms. Grove Casey

Well. Are there any control measures that we, as you know, those assisting our clients could make use of or suggest to help prevent fraud?

Ms. Watters

Sure. I mean, I think I certainly address some of those controls, but I think that the number one piece of advice to help prevent controls is just for individuals to be aware of what is going on in their business environment and beyond that lookout for red flags of fraud. First of all, you have to maintain some healthy degree of skepticism. Don't just assume that everybody who works for you is honest and wouldn't possibly steal from you. I'm not saying assume that everybody is a thief either, right? It's somewhere in the middle. Healthy skepticism. But remain involved and be present. Don't just see the running of your business to somebody else in the business I talked about just a second ago those folks, they just love that woman. They just considered her a daughter and she would never steal from them. And they would go out of the country for years at a time on a mission. That's a while on a mission. They were very dedicated.

Ms. Grove Casey

Philanthropic

Ms. Watters

Yes. Dedicated to their religion. And they would go on an organized mission for a year or sometimes two and they never gave their business a thought because this woman was, she had it all under control didn't care about. Yeah. And it was, to be honest with you, it was really sad because when she was found out they were broken hearted. I mean, they just were astonished and heartbroken that this woman that they loved so much would steal from them and that they entrusted. I would encourage business owners, I mentioned red flags of fraud before, but get on the internet and do a little bit of research become familiar with those red flags of fraud— people living above their means, things of this nature so that you kind of have an idea what you should be on the alert for.

SUPPLEMENTAL MATERIALS

Covid Related Assistance Programs and Related Fraud Issues

In addition to vaccine fraud schemes and identity theft of individuals, unemployment fraud has also increased since the start of the pandemic. Sometimes that's perpetrated through stolen personal information, so both business and personal clients should be informed of potential fraud schemes that are common.

Unemployment Fraud

At the beginning of the pandemic, many people were unemployed and unemployment claims rose dramatically. While some states were overwhelmed with the number of claims causing their systems to fail, not all of those claims were legitimate. In particular, those who have been the victim of identity theft in the past and who have had personally identifiable information exposed are at risk of having a false unemployment claim made in their name. Indicators that a person may be the victim of fraudulent unemployment claims include receiving a notice that a claim has been rejected due to an existing claim in the name of the person; a determination letter that an application letter has been received, but the person did not submit one; a person is told by a current or former employer that a UI claim was submitted with the person's PII.

Both the individual and their employer have filings to make in the event that a UI fraud is committed. The U.S. Department of Justice has a fraud consumer protection guide available at <https://www.justice.gov/media/1129171/dl?inline> to help consumers with reporting and protecting themselves. Good computer hygiene and cybersecurity practices can help protect people from fraud. Things like second factor authentication and making new and complex passwords that are changed frequently.

The Department of Justice has been cracking down on these types of cases. Recently, a Pennsylvania inmate was sentenced to 11 months for pandemic unemployment fraud. Personal information was gathered from other inmates, claims filed, and funds sent to an address where they were then accessed.

Employee Retention Credit (ERC)

The ERC was established as part of the CARES Act in 2020 within a few weeks of the initial shutdown due to

the Covid 19 virus. The criteria for eligible businesses were that either the business was fully or partially shut down due to a governmental order during any part of 2020, or the business's gross receipts in any quarter of 2020 declined 50% or more relative to the same quarter of 2019. A yes to either of the criteria and for businesses with 100 or fewer employees, made any wages paid to an employee while the business was shut down or partially shut down or where it had a 50% decline in gross receipts may count towards the \$10,000 per employee amount. The tax credit applies against certain payroll taxes (included employer portion of social security) for wages paid between March 12, 2020 and December 31, 2020. The credit is for 50% of wages paid per employee, capped at \$5,000 per employee.

The 2021 version of the ERC was expanded and businesses with or fewer employees were eligible. The credit is available for all 4 quarters up to \$7,000 per quarter, and only a 20% reduction in gross receipts in a single quarter will make business eligible, resulting in a maximum annual benefit of \$28,000 per employee.

Despite the fact that time has passed, returns may still be amended by eligible businesses. As a result, it may be worthwhile to review whether or not clients may need to amend to claim any credits they are eligible for. The ability to still receive these credits has continued to make fraudsters sit up and pay attention as well.

There are several common types of payroll fraud and a few of those have been used related to the ERC. The use of ghost or fictitious employees or even fictitious companies is one scenario that has been observed related to the employee retention credit. Additional issues have occurred related to timesheets, wages, and rates paid as well. While detecting fraud is good, preventing fraud is better. Internal controls over payroll can include things like time clocks, intermittent review or payouts of payroll, and periodic rate reviews. Separation of duties and written policies and procedures related to payroll are also key in establishing and maintaining controls.

American Rescue Plan Paid Leave

The American Rescue Plan offered paid leave credits through September for small and midsize businesses who offered paid leave to workers due to illness,

quarantine, or caregiving due to the virus. The credit was a dollar-for-dollar credit up to \$5,000 of wages. While the law no longer requires businesses to offer the leave, the credit was still available through September 2021. Amendments to those payroll returns may still be filed for those that did not claim the credit previously and are eligible.

Emergency Capital Investment Program

The Emergency Capital Investment Program (ECIP) was established by the Consolidated Appropriations Act 2021 to encourage low and moderate income community financial institutions to increase their efforts at supporting small businesses and consumers in their communities. Treasury was providing up to \$9 billion in capital directly to certified CDFIs (Community Development Financial Institutions) and MDIs (Minority Development Institutions) to provide loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers in financially underserved communities. More information may be found at home.treasury.gov/policy-issues/coronavirus/assistance-for-small-businesses/emergency-capital-investment-program.

Editorial Note: While reporting for the first round of ECIP is expected to occur in January 2023, Treasury recently opened a second round of funding with approximately \$160 to \$340 million available for investment. The deadline for applications is January 31, 2023.

PPP Loans (Paycheck Protection Program)

The Paycheck Protection Program was established by the CARES Act and implemented by the Small Business Administration (SBA) with support from Treasury. The program was intended to help small businesses with funds for operating costs like payroll, mortgages, rent, and utilities. A variety of organizations were eligible for the assistance and the money was disbursed relatively quickly. These loans allowed interest and principal to be forgiven if the expenses were spent within a given timeframe and a certain percentage was spent on payroll. So far, this is where the vast majority of the covid-related fraud seems to have occurred. From false statements related to business establishment to fictitious businesses and/or employees, many cases are now being tried by the Department of Justice. In Eastern Virginia alone, in 2022 fraud cases related to PPP loans included

individual business owners inflating payroll to serial fraudsters applying for multiple loans with false claims about organizations and income. Purchases of luxury cars, boats, jewelry, and real estate have been where some of the misappropriated funds were spent. Not all cases are small, as one case was related to 80 fraudulent PPP loan applications totaling over \$100 million in funds.

EIDL (Economic Injury Disaster Loan) Program

The EIDL program was also administered by the SBA. The program was designed to provide economic relief to small businesses with a temporary loss of revenue. This program too has resulted in many fraud actions being brought.

Common Types of Frauds and Potential Prevention

The OIG (Office of Inspector General) has provided some tips and suggestions on detecting and deterring fraud in Small Business Administration business loan programs in Information Notice 9000-1793. It should be noted that the OIG obtains convictions of both borrowers and loan agents every year; however, with the American Recovery and Reinvestment Act implementation, a significant increase in volume of both loans and fraud cases is anticipated.

Patterns that the OIG has identified as the most common fraud schemes related to SBA loans include both loan agent fraud and borrower fraud. With regard to loan agent fraud, lenders are encouraged to consider the following as potential fraud indicators: loan agents with a record of early defaults; the agent controls all the communications between the lender and the borrower; the agent threatens to shop the loan, excessive fees are charged; specific appraisers and title companies are required; multiple loan applications are submitted simultaneously to different lenders for the same borrower (found via credit reports); among other indicators.

Loan agents are not the only party who may be participating in loan fraud as borrowers may intentionally provide false information to the SBA and lenders either alone or in collusion with others. While false equity injection (like false gift letters or affidavits; false notes or standby arrangements; false financial statements; or false bank statements or cashier's checks) is the most common, there are other borrower types of fraud. These other types include overstating

income; understating or omitting liabilities; overvaluing collateral; failing to disclose a criminal record, false claims related to citizenship, ownership of a business, work history, or even Social Security numbers to conceal a poor credit history.

For protection against corrupt loan agents, lenders should consider the following:

- Tracking loan agent participation to see if agents are bringing a larger number of loans that experience early default or other significant problems;
- Asking for references from other lending institutions;
- Communicating directly with borrowers about loan applications, the agent's performance and fees; and
- Using reputable appraisers and title companies known to the lender.

When equity injection is a potential risk, lenders may want an affidavit detailing the gift and that it does not need to be repaid; for wired funds, request a copy of the wire transfer and include it in the file; and for inherited funds, verify that the funds exist via bank statement prior to disbursement.

Very little fraud has been identified among lenders, although one recent case resulted in an \$85 million loss, so one still needs to be aware of the potential. The SBA has suggested the following processes and procedures to deter and detect suspicious lending activity and as always, an objective mindset is key.

Certain key procedures include:

- Management oversight of loan approvals, especially larger loan amounts;
- Policies and Codes of Conduct requiring disclosure where loan agents are involved in generating or packaging loans;
- Limits on commissions or incentives for quantity loan volume;
- Internal review and audit where certain lending officials may have a large number of loans with issues or significant problems;

- Internal review and audit where certain lending officials may have a larger volume of loans, especially if they are known to work with certain loan agents; and
- Policies related to higher due diligence in reviewing change of ownership transactions.

For practitioners who suspect fraud, the OIG asks that it be reported immediately either through the hotline at 800-767-0385 or at OIGHotline@sba.gov.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss indicators that a person may be the victim of fraudulent unemployment claims.
2. Discuss the ERC and eligibility.
3. Discuss the types of payroll fraud associated with the ERC.
4. Discuss the Emergency Capital Investment Program.
5. Discuss common types of SBA loan frauds.
6. Discuss policies and procedures that could help in detecting and deterring SBA loan fraud.

B. Suggested Answers to Discussion Problems

1. At the beginning of the pandemic, many people were unemployed and unemployment claims rose dramatically. While some states were overwhelmed with the number of claims causing their systems to fail, not all of those claims were legitimate. In particular, those who have been the victim of identity theft in the past and who have had personally identifiable information exposed are at risk of having a false unemployment claim made in their name. Indicators that a person may be the victim of fraudulent unemployment claims include receiving a notice that a claim has been rejected due to an existing claim in the name of the person; a determination letter that an application letter has been received, but the person did not submit one; a person is told by a current or former employer that a UI claim was submitted with the person's PII.

2. The ERC was established as part of the CARES Act in 2020 within a few weeks of the initial shutdown due to the Covid 19 virus. The criteria for eligible businesses were that either the business was fully or partially shut down due to a governmental order during any part of 2020, or the business's gross receipts in any quarter of 2020 declined 50% or more relative to the same quarter of 2019. A yes to either of the criteria and for businesses with 100 or fewer employees, made any wages paid to an employee while the business was shut down or partially shut down or where it had a 50% decline in gross receipts may count towards the \$10,000 per employee amount. The tax credit applies against certain payroll taxes (included employer portion of social security) for wages paid between March 12, 2020 and December 31, 2020. The credit is for 50% of wages paid per employee, capped at \$5,000 per employee.

The 2021 version of the ERC was expanded and businesses with or fewer employees were eligible. The credit is available for all 4 quarters up to \$7,000 per quarter, and only a 20% reduction in gross receipts in a single quarter will make business eligible, resulting in a maximum annual benefit of \$28,000 per employee.

3. There are several common types of payroll fraud and a few of those have been used related to the ERC. The use of ghost or fictitious employees or

even fictitious companies is one scenario that has been observed related to the employee retention credit. Additional issues have occurred related to timesheets, wages, and rates paid as well. While detecting fraud is good, preventing fraud is better. Internal controls over payroll can include things like time clocks, intermittent review or payouts of payroll, and periodic rate reviews. Separation of duties and written policies and procedures related to payroll are also key in establishing and maintaining controls.

4. The Emergency Capital Investment Program (ECIP) was established by the Consolidated Appropriations Act 2021 to encourage low and moderate income community financial institutions to increase their efforts at supporting small businesses and consumers in their communities. Treasury was providing up to \$9 billion in capital directly to certified CDFIs (Community Development Financial Institutions) and MDIs (Minority Development Institutions) to provide loans, grants, and forbearance for small businesses, minority-owned businesses, and consumers in financially underserved communities.
5. Patterns that the OIG has identified as the most common fraud schemes related to SBA loans include both loan agent fraud and borrower fraud. With regard to loan agent fraud, lenders are encouraged to consider the following as potential fraud indicators: loan agents with a record of early defaults; the agent controls all the communications between the lender and the borrower; the agent threatens to shop the loan, excessive fees are charged; specific appraisers and title companies are required; multiple loan applications are submitted simultaneously to different lenders for the same borrower (found via credit reports); among other indicators.

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- Management oversight of loan approvals, especially larger loan amounts;
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GLOSSARY OF KEY TERMS

CARES Act—the Coronavirus Aid, Relief, and Economic Security Act

Control Activities—processes and procedures that you put in place to mitigate the risk that you identified back in the risk assessment stage

Control Environment— the set of standards, processes, and structures that provide the basis for carrying out internal control across the organization

Emergency Capital Investment Program—program created to encourage low and moderate income community financial institutions to expand their efforts to support small businesses and consumers in their communities

EIDL—Economic Injury Disaster Loan

ERC—Employee Retention Credit created under the CARES Act

Fraud Pentagon—fraud pentagon theory expands on the fraud triangle of opportunity, rationalization, and pressure, by adding competence and arrogance.

Phantom Stock—a promise an employee will receive either the value of the company shares or an amount that the stock price increases during a specified period

PPP Loans—Paycheck Protection Program created by the CARES Act it provided small businesses with forgivable loans that would pay up to eight weeks of payroll cost, including benefits. The funds could also be used to pay interest on mortgages, rent, utilities

Stock Appreciation Rights (SARs)—a type of employee compensation linked to an entity's stock price during a predetermined period

CUMULATIVE INDEX 2023

BY TOPIC

Topic	Month–Page	Topic	Month–Page
American Rescue Plan.....	Jan-20	Information and Communication.....	Jan-25
Borrower Fraud	Jan-23	Internal Controls.....	Jan-25
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COSO Model.....	Jan-25	Payroll Taxes.....	Jan-19
Cybersecurity	Jan-27	Phantom Stock	Jan-3
Economic Injury Disaster Loan	Jan-22	PPP Loans	Jan-21
Emergency Capital Investment Program	Jan-20	Risk Assessment.....	Jan-26
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BY CITATION

Citation	Month–Page	Citation	Month–Page
ASC 712	Jan-3	ASU 2021-07	Jan-5
ASC 715	Jan-3	Topic 480	Jan-4
ASC 718	Jan-3	Topic 710	Jan-3

BY SPEAKER

Speaker	Month	Speaker	Month
Russ Madray.....	Jan	Lee Ann Watters.....	Jan

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 Topics provides accounting guidance on stock appreciation rights?
 - A. ASC 710.
 - B. ASC 712.
 - C. ASC 718.
 - D. ASC 720.

2. According to Russ Madray, stock appreciation rights are profitable for employees when which of the following occurs?
 - A. The company's stock price rises and the employee pays the exercise price.
 - B. The company's stock price declines and the employee pays the exercise price.
 - C. The company's stock price rises alone.
 - D. The company's stock price declines alone.

3. According to Russ Madray, a stock settled SAR (stock appreciation right) would be classified as which of the following?
 - A. Equity, providing it meets the other criteria for equity classification.
 - B. Liability.
 - C. Asset.
 - D. Contra equity.

4. According to Russ Madray, for cash-settled SARs with performance conditions, fair value is determined using which of the following?
 - A. Current market value of the stock.
 - B. An option pricing model.
 - C. Historical value of the stock at the last reporting period date.
 - D. Par value of the stock.

5. According to Russ Madray, for a liability classified SAR award, which of the following is correct?
 - A. The value of the liability will remain constant over time.
 - B. The value of the liability and corresponding compensation expense will need to be periodically adjusted for changes in the fair value of the SAR.
 - C. The value of the liability will be adjusted for the changes in the fair value of the SAR, as well as retained earnings.
 - D. The value of the liability will remain constant, but compensation expense will be adjusted for any market value changes.

Continued on next page

6. According to Lee Ann Watters, the Employee Retention Credit was available for which of the following?
- A. The first quarter of 2021.
 - B. Through September 30, 2021.
 - C. All four quarters of 2021.
 - D. Not applicable in 2021.
7. According to Lee Ann Watters, the Emergency Capital Investment Program (ECIP) provided approximately how much to depository institutions that are considered certified community development financial institutions (CDFIs) or minority depository institutions (MDIs) to provide loans, grants, and forbearance for small businesses, minority owned businesses, and consumers?
- A. \$28,000 per employee.
 - B. \$5 billion.
 - C. \$9 billion.
 - D. \$15 billion.
8. According to Lee Ann Watters, approximately how much is the estimated total fraud of all covid-related funds?
- A. \$250 billion.
 - B. \$500 billion.
 - C. \$550 billion.
 - D. \$579 billion.
9. According to Lee Ann Watters, which of the following were common types of fraud related to PPP loans?
- A. Identity theft.
 - B. Loan agent fraud.
 - C. Fictitious companies.
 - D. Unemployment insurance.
10. According to Lee Ann Watters, which of the following is the biggest red flag that borrower fraud is occurring related to PPP loans?
- A. False documents.
 - B. Failing to disclose liabilities and debts.
 - C. A credit report that doesn't support the information from the borrower.
 - D. Failing to disclose a criminal record.
11. According to Lee Ann Watters, which of the following expands on the element of opportunity in the fraud triangle?
- A. False statements.
 - B. Capability.
 - C. Rationalization.
 - D. Pressure.

Continued on next page

12. According to Lee Ann Watters, which of the following is the first component of the COSO model on internal control?
 - A. Control environment.
 - B. Risk assessment.
 - C. Information and communication.
 - D. Monitoring.
13. According to Lee Ann Watters, risk assessment involves which of the following?
 - A. Internal risks only.
 - B. External risks only.
 - C. Both internal and external risks to the entity.
 - D. Only operational risks.
14. According to Lee Ann Watters, one of the key control breakdowns in the PPP loan program was which of the following?
 - A. There was not a centralized entity to lead and manage the process.
 - B. There was too much guidance available to the issuing banks.
 - C. There was a good set of guidelines to use in conducting risk assessment.
 - D. Roles and responsibilities were clearly defined.
15. According to Lee Ann Watters, which of the following entities would have struggled the most during Covid?
 - A. A small entity heavily invested in IT with strong cybersecurity.
 - B. A medium-sized entity that had some processes that were automated, but mostly manual review and paper centric.
 - C. A large technologically advanced entity where staff were equipped with laptops and strong cybersecurity.
 - D. A medium-sized entity that had well established IT networks and the ability for people to work remotely.

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 January 2023 **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 Stock Appreciation Rights	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Covid Related Fraud	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

Which segments of the January 2023 issue of **CPE Network® A&A Report** did you like the most, and why?

Which segments of the January 2023 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 January 2023 CPE Network® A&A Report? Rate each speaker on a scale of 1–5 (5 highest):

	Overall	Knowledge of Topic	Presentation Skills
Russ Madray			
Lee Ann Watters			

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 program materials accurate? Yes ☐ No ☐ _____

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

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

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

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

Specific Comments: _____

Name/Company _____

Address _____

City/State/Zip _____

Email _____

Once Again, Thank You...

Your Input Can Have a Direct Influence on Future Issues!

CPE Network®

Firm/Company Name: _____

Account #:

Location:

Program Title: _____

Date: _____

[illegible]

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 <u>3 times per CPE hour</u> . This is achieved via polling questions. Sponsors must have a report which documents the responses from each student. The timing of the polling questions should be random and not made known to students prior to delivery of the course. Record the polling question responses below. Refer to the CPL Network User Guide for more instructions. Partial credit will not be issued for students who do not respond to at least 3 polling questions per CPE hour.
Brief Description of Method of Polling	Example: Zoom: During this webinar, moderator asked students to raise their hands 3 times per CPE hour. The instructor then noted the hands that were raised in the columns below.

[illegible]

CHECKPOINT LEARNING NETWORK

CPE NETWORK[®]

USER GUIDE

REVISED 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

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

“Group Live” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance

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

Use the **attendance sheet**. This lists the instructor(s) name and credentials, as well as the first and last name of each participant attending the seminar. The participant is expected to initial the sheet for their morning attendance and provide their signature for their afternoon attendance. If a participant arrives late, leaves early, or is a “no show,” the actual hours they

attended should be documented on the sign-in sheet and will be reflected on the participant's CPE certificate.

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Make-Up Sessions

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

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Advertising / Promotional Page

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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:

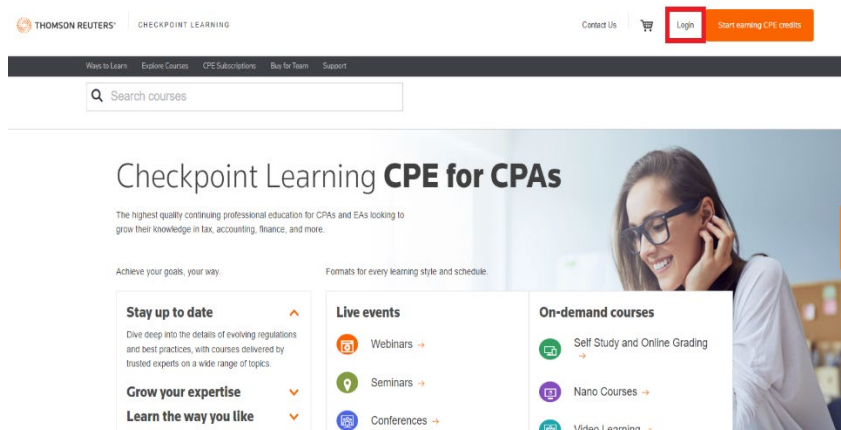
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

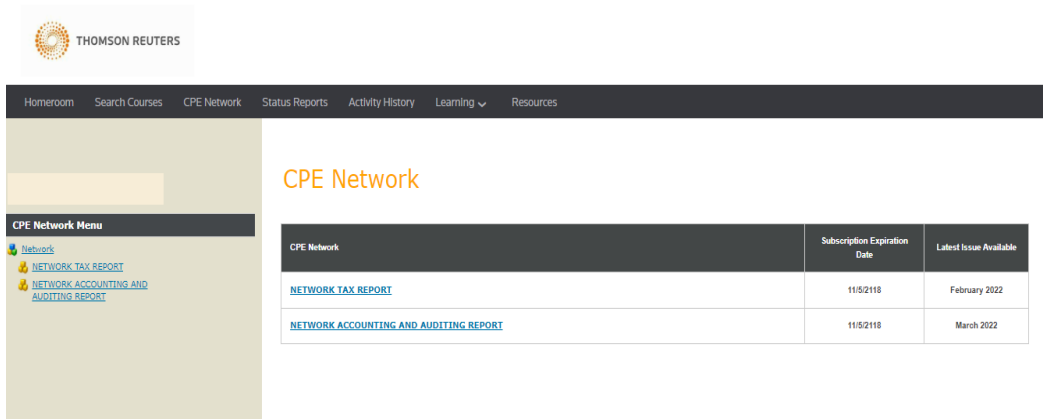
Self-Study—Online

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”).

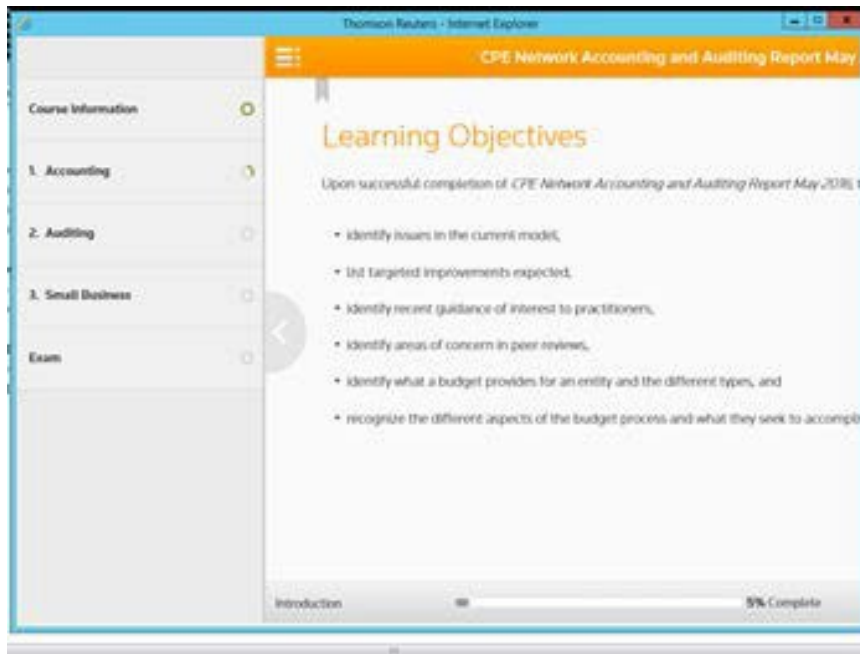


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



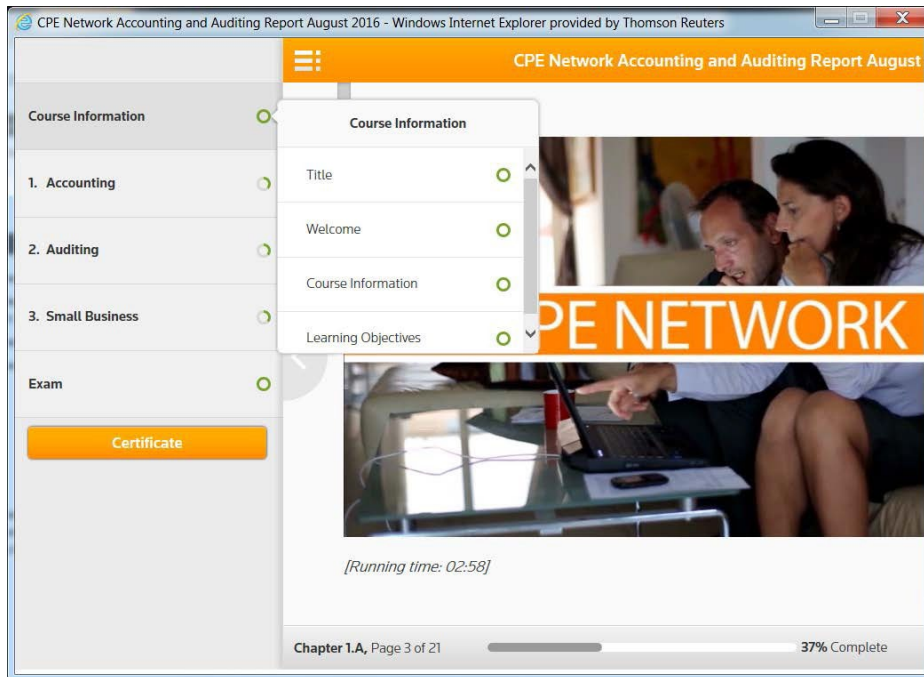
CPE Network	Subscription Expiration Date	Latest Issue Available
NETWORK TAX REPORT	11/5/2118	February 2022
NETWORK ACCOUNTING AND AUDITING REPORT	11/5/2118	March 2022

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

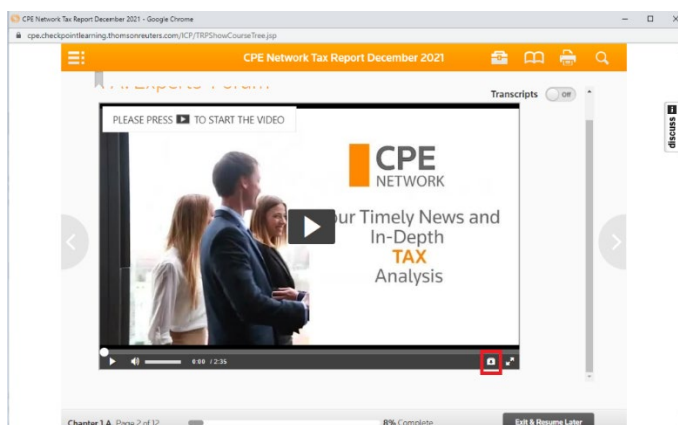


Click down to access the dropdown menu and move between the program Chapters.

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



- **Each Chapter is 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.

Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2016

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

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

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

Ms. Grove Casey

Today, we want to talk a little bit

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

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

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

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

Transcripts ☒

Chapter 1 Liabilities and Equity: Another Look at the Model

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CURRENT ANALYSIS AND COMMENTARY
PART I. ACCOUNTING

Liabilities and Equity: Another Look at the Model

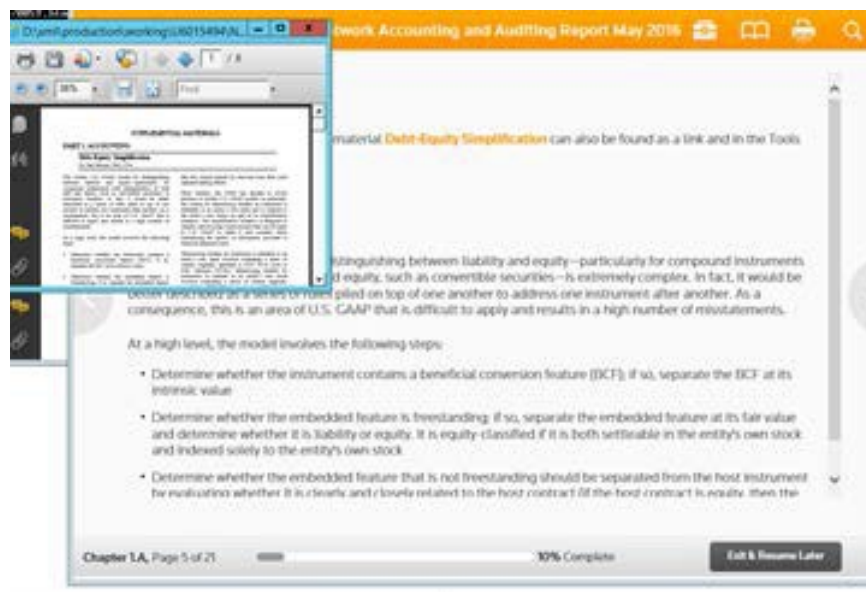
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Ms. Grove Casey

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



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

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

The screenshot shows a web interface for the CPE Network Accounting and Auditing Report July 2016. The header is orange with a menu icon, title, and icons for a calculator, book, printer, and search. The main content area is titled "Suggested Answers to Discussion Problems" and contains three numbered items. Item 1 lists three categories: Held-to-maturity, Trading, and Available-for-sale, followed by a paragraph explaining the classification process. Item 2 describes the trading securities category. Item 3 discusses impairment recognition. The footer shows "Chapter 3.A, Page 20 of 20", a progress bar at 100% Complete, and an "Exit & Resume Later" button.

Suggested Answers to Discussion Problems

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

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

Chapter 3.A, Page 20 of 20 100% Complete Exit & Resume Later

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

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

The screenshot shows a web interface for the CPE Network Accounting and Auditing Report June 2016. The header is orange with a menu icon, title, and icons for a calculator, book, printer, and search. The main content area is titled "Course Exams Completed" and contains a message stating the exam is completed. It then provides instructions on how to review or grade answers, with two orange buttons: "Review My Answers" and "Grade My Answers". The footer shows "Course, Completed", a progress bar at 100% Complete, and an "Exit & Resume Later" button.

Course Exams Completed

You have completed the exam for this course.

Please choose your next course of action by selecting on one of the buttons below.

"Review My Answers" will take you back through exam, giving you the opportunity to make changes.

Review My Answers

"Grade My Answers" will result in providing you with a final score for this course.

Grade My Answers

Course, Completed 100% Complete Exit & Resume Later

- 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.

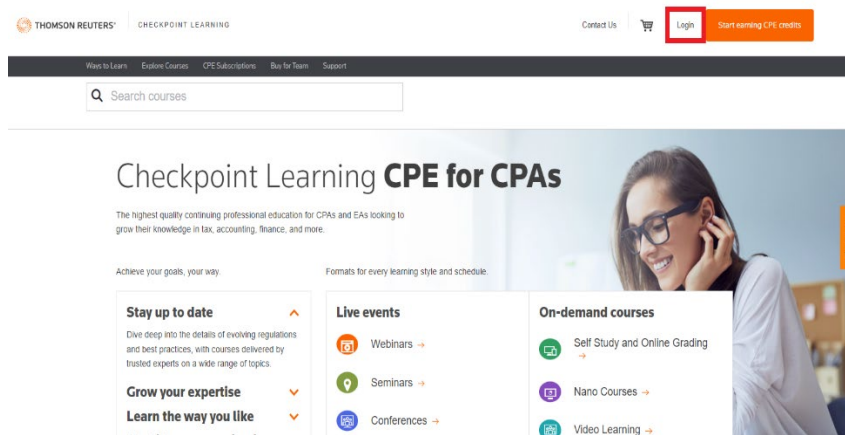
Print

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**.

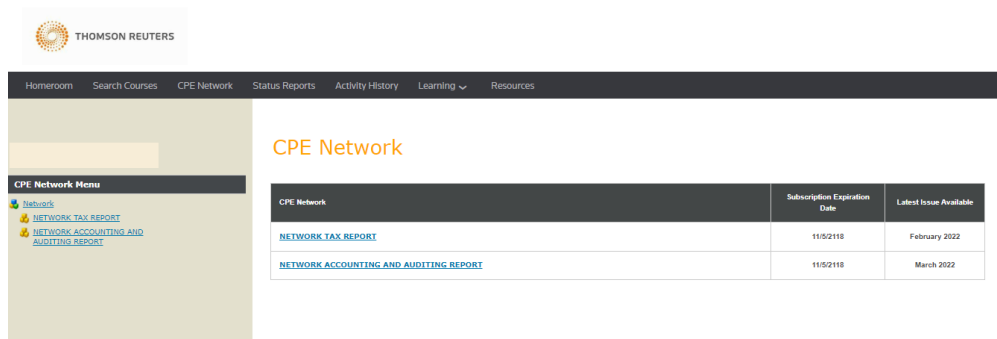
Transitioning From DVDs

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

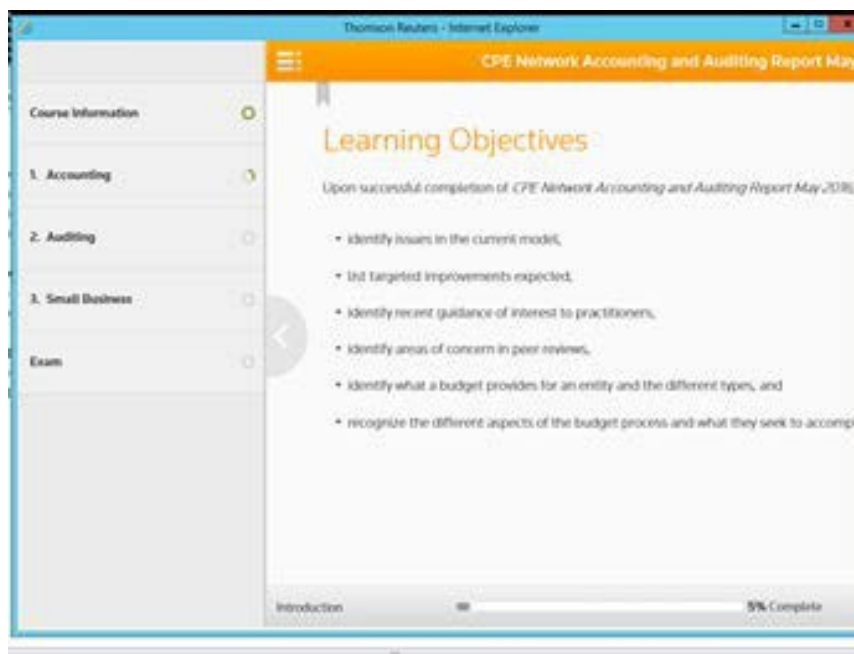
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



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

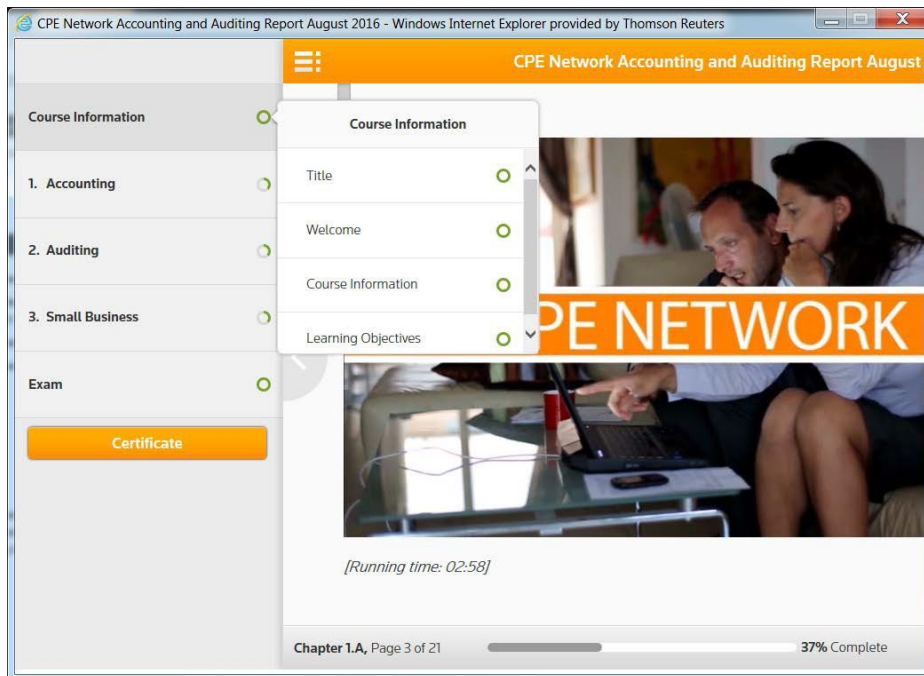


The Chapter Menu is in the gray bar at the left of your screen:

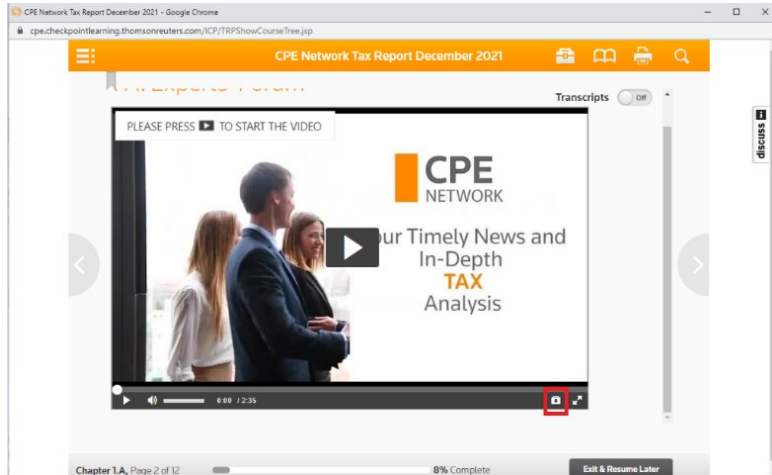


Click down to access the dropdown menu and move between the program Chapters.

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



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



Video segments may be downloaded from the CPL player by clicking on the download button noted above. 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

Determining CPE Credit Increments

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

Program Presentation

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

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

1. Stated learning objectives were met.
2. Prerequisite requirements were appropriate.
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	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	800.431.9025 (follow option prompts)	checkpointlearning.productsupport@thomsonreuters.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	800.431.9025 (follow option prompts)	checkpointlearning.cpecustomerservice@thomsonreuters.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates