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**CPE NETWORK**

## ACCOUNTING & AUDITING REPORT

**FEBRUARY 2023**

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Topics for future editions may include:

- Goodwill Disclosures
- Recent PCAOB and SEC Enforcement
- FRF for SMEs



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## EXECUTIVE SUMMARY

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### PART 1. ACCOUNTING

#### ASC 740 Income Tax Disclosures ..... 3

Russ Madray, CPA explains the disclosures required in accounting for income taxes. [*Running time: 40:00*]

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

- Identify where disclosures are located in the financial statements
- Identify what disclosures are required
- Define disregarded entities

### PART 2. AUDITING

#### Recent PCAOB Auditing Standards Activity ..... 19

Jennifer Louis, CPA reviews recent PCAOB auditing guidance. [*Running time: 28:15*]

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

- Define referred to auditors and the responsibilities of lead auditors
- Identify the PCAOB mission and focus
- Identify the focus of the PCAOB related to the use of technology in audits

### PART 3. SMALL BUSINESS

#### Efficiencies in Review Engagements ..... 37

Kurt Oestrieher, CPA, discusses what sets a review engagement apart from other services and ways to make those engagements efficient. [*Running time: 32:10*]

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

- Identify the differences between reviews, audits, compilations, and preparations
- Identify actions improving efficiency in review engagements
- Identify the impact of SSARS 25 and materiality calculations on review engagements

## ABOUT THE SPEAKERS

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

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

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

Be sure to include the completed sheet when you request certificates for this event.

Title of Course (Enter full title)	
Date of Class (MM/DD/YYYY)	
Time (Enter time of class)	
Location (Enter location of class)	
Learning Objectives (Refer to executive summary)	
Program Description (Refer to executive summary)	
Instructional delivery method	Group Live
Recommended CPE credit	3.0 Credits
Recommended field of study(ies) (Refer to executive summary)	
Program Level	Update
Prerequisites (Circle One)	<ul style="list-style-type: none"><li>• Basic Accounting and Auditing professional experience</li><li>• Basic Tax professional experience</li><li>• Basic Governmental professional experience</li></ul>
Advance preparation	None required
Course registration and, where applicable, attendance requirements <sup>(1)</sup>	

(1) Insert instructions for your students to register for the class and any other attendance requirements (e.g., bring your laptop, be prepared to work in groups, you will be required to sign in and sign out of the session, etc.)

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### PART 1. ACCOUNTING

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#### ASC 740 Income Tax Disclosures

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While the information in the financial statements can be critical to a user's decision making, many times it's just a number and the notes to the statements provide substantially more information. The notes provide a tremendous amount of information surrounding certain transactions or events, and on occasion assumptions used in determining the numbers. There has always been a considerable amount of disclosure around the income tax transactions showing in the financial statements. In 2016, the FASB proposed changes to the disclosure requirements. While the TCJA resulted in a revised proposal in 2019, the FASB continues to try to simplify accounting for income taxes and the related disclosures.

For more on the disclosures associated with accounting for income taxes, let's join Russ Madray, a CPA in Greenville, South Carolina, and C-P-E Network's Debi Grove Casey.

#### Ms. Grove Casey

Today we want to talk about ASC 740, which is the FASB topic that relates to income taxes and, in particular, to the disclosure requirements. The information provided by the recognized amounts in the financial statements is important, but the information that can be provided in that form is inherently limited because it is just a number. Disclosures are a huge portion of the financial statements, particularly if you are trying to make decisions related to them. With that in mind, could you give us an overview of the disclosure requirements related to income taxes?

#### Mr. Madray

Sure, I would be glad to. You are right, the information that is conveyed through the amounts in the financial statements is, obviously, fundamental but, as you just said, the information that can be conveyed through what is on the face of the financial statements is limited in terms of what can be conveyed. As we all know, the notes to the financial statements are going to provide the relevant information that is not provided in those numbers that are on the face of the financial statements. Again, I think we all know this but, just as a reminder, the notes provide information that explains the specific line items on the face of the financial statements. They provide information about past events, current circumstances, conditions, and so forth, that, maybe, have not been recognized in the financial statements but will affect future cash flows.

Clearly, what we are saying is that the notes are an integral part of understanding what is in the financial statements and we want to talk about those disclosure

requirements—note disclosure requirements related to income taxes—because this is an area where we do see some problems; it shows up in peer review in terms of missing or incorrect disclosures. The authoritative guidance for this, of course, is found in the Accounting Standards Codification (ASC) Topic 740, specifically ASC 740-10-50, which is the disclosure section. That is the source of all the guidance on disclosures related to income taxes and it does apply to all entities.

Now, if you look through that section of guidance, you can group those disclosure requirements into these categories that we see on the slide here. There are disclosures related to deferred taxes, disclosures related to operating losses and tax carryforwards, and specific requirements related to changes in tax status; there are some specific disclosure requirements related to temporary differences in tax carryforwards and requirements related to disclosing the significant components of the income tax expense; there is that rate reconciliation requirement, and then, a whole host of disclosures related to unrecognized tax benefits. Once you get through all that, there are still a couple of other things to keep in mind that fall outside—actually come from other parts—of the Codification topic. So, there is quite a bit there.

We should mention, too, that there is an ongoing project at the FASB to improve the disclosures specifically related to income taxes. The Board issued a proposed Accounting Standards Update (ASU) in 2016 called, *Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*, and the purpose of that was to provide some enhanced disclosure requirements related to income taxes. Although that was proposed in 2016, Congress passed the Tax Cuts and Jobs Act in

December of 2017 so, as a result of that, the FASB, a year or so later, issued a revised proposed ASU related to this topic. Broadly, what this proposal will do is remove disclosures that are no longer considered to be cost beneficial or relevant and, also, add some new disclosure requirements that have been identified as being relevant to financial statement users. Again, I just wanted to mention that because, even though what we are talking about today are current requirements, there will be changes to this in the future. It won't be any time in the near, near term but, down the road, maybe in a year or so, we will be talking about some improvements and changes to what we are actually talking about today. But we have to live with what is out there today, and that is what we are going to try to discuss in our time together today.

**Ms. Grove Casey**

Well, it is certainly not like they haven't addressed this area in the past—repeatedly—but let's start with deferred taxes because we do have to live with what we have right now. What are the requirements for those disclosures?

**Mr. Madray**

Related to deferred taxes, entities, essentially, need to disclose separately the three components that make up the deferred tax balance in the balance sheet and we have that on this next slide. We have to disclose the total amount of deferred tax liabilities that have been determined, then, also, the total amount of deferred tax assets that have been determined in accordance with those applicable sections in ASC 740 and, then, the total amount of the valuation allowance on the deferred tax assets. The primary reason for this is because, due to some changes several years ago, our deferred tax amount is presented as a net amount on the balance sheet. So, the disclosures are required to provide the components that make up that overall deferred tax balance.

Beyond that, entities also need to disclose the net change in the valuation allowance that has occurred during the reporting period. And further, ASC 740 requires that the types of temporary differences that give rise to any significant portions of the deferred tax asset or liability also need to be disclosed. The guidance does not prescribe how those differences should be disclosed, so there is some leeway there in terms of how you identify those significant portions and how that would be disclosed in the applicable disclosure.

On this next slide, we have an example that hits on these things that we just mentioned related to deferred tax balances. So, if we want to take a look at that, you will see some of it in this example appearing in the accounting policy note. Again, without going through and reading all of this, I do want to point out a few things that we see here. You notice we describe in this example that income taxes are provided for the tax effects of transactions that are reported in the financial statements and consist of taxes that are currently due, plus the deferred taxes. Then, there is an explanation of deferred taxes being recognized for the differences between the basis of assets and liabilities for book purposes and tax purposes. Then, we describe the differences that relate primarily to depreciable assets, allowance for doubtful receivables, and profit on installment sales. It goes on to describe the concept of the deferred tax asset and liabilities that represent the future tax return consequences of these differences that will be either deductible or taxable when they are recovered or settled.

Then, more of this requirement surrounding deferred taxes in this example is in the actual income tax note. Here we have the quantitative breakdown: the total deferred tax liabilities, deferred tax assets, and deferred tax asset valuation allowances at the end of each year are provided in this table. So, we see the total deferred tax assets each year, the valuation allowance each year, the net deferred tax assets, then the total deferred tax liabilities. We have the net between the deferred tax liabilities and deferred tax assets and, then, an explanation of the valuation allowance and how we determine the valuation allowance—in this example on a quarterly basis—that consider all positive and negative evidence including scheduled reversals of deferred tax liabilities, and so on. This one, obviously, is an example from during the pandemic where we describe the uncertainties in forecasting operating results due to the continued impact of COVID-19, and so on. So, again, without further reading through all of this example which we can clearly do for ourselves, I just wanted to point out a few of those things that are specific to that requirement related to the deferred tax balances. In this example, again, portions of it were in the policy note, and portions of it were in the income tax note. It is not unusual to see things placed in the proper context in different notes in the notes to the financial statements.

**Ms. Grove Casey**

Let's move on to tax credit carryforwards. Are there specific disclosure requirements related to those?

**Mr. Madray**

Yes, there are. Essentially, entities would need to disclose the information that we see on this next slide related to our operating losses and tax credit carryforwards. Broadly, there are two areas of requirements: the amounts of the operating losses and tax credit carryforwards that are taken on the tax returns and the dates on which those amounts will expire; then, also, the amount of any valuation allowance on the deferred tax assets where the reporting entity will credit any future recognized tax benefits to shareholders' equity. So, for example, a deferred tax asset that relates to a net unrealized loss on an available-for-sale security. Those are the two main requirements.

In the next slide we have an example of this, and this is actually taken from a private company financial statement related to operating losses and tax carryforwards. So, there is not as much in this example because, in this private company setting, you don't have a whole lot of the things that could lead to the operating losses and tax credit carryforwards, or tax carryforwards, that we might see in a larger, global company, but it is a good simple example. As you see here, at June 30th, 2019, in 2018 the company has net operating losses of zero in the most recent year, and \$174,000 in the prior year, that is available to carry forward to future years. These operating losses begin to expire in June of 2030. So, again, two main things, and in this simple example we see, essentially, just the amount of the operating losses and the dates where they would expire. Again, if we did have a situation where we would have anything where the future recognized tax benefits would be credited to shareholders' equity, that is the additional requirement related to those types of items.

**Ms. Grove Casey**

You mentioned disclosures related to a change in tax status. I assume this would be a type of subsequent event disclosure.

**Mr. Madray**

Yes, you are exactly right. If an entity changes its tax status after the end of the reporting year—after the balance sheet date but before the financial statements are available to be issued—this clearly falls into that subsequent event-type of thing that comes from ASC 855 on subsequent events. In that case, there are two items that we have to disclose in the financial

statements related to this change in tax status. As you see on this slide, we need to disclose the change in tax status that occurred after year end and then, also, the effect of that change on the financial statements, if that effect would be material.

The next slide has an example of this, again, taken from a private company as opposed to a public company, because there could be some more complex changes in tax status. This is one that is not unusual to see. Again, we have it in two places: in the income tax note and also in the subsequent event note. So, in the income tax note, we state that on January 1st, 2021, the company filed an election with the Internal Revenue Service electing to be treated as a taxable corporation for U.S. federal income tax purposes, effective January 2nd, 2021, and then we refer to the subsequent event note. In the subsequent event note, we state that as discussed in the income tax note, the company filed an election with the Internal Revenue Service electing to be treated as a taxable corporation for U.S. federal income tax purposes, effective January 2nd, 2021.

Again, depending on the situation and the entity, changes in tax status can run the gamut. There could be members of a consolidated return changing, and a variety of other things. A fairly common one that we see in the private-company world is a change in an S election, or electing out of the S election, as the example that we saw right there would show. Regardless, for any kind of change in tax status, we need to disclose what that change was and the effect on the financial statements, if that effect would be considered material.

**Ms. Grove Casey**

You have mentioned a couple of times that some of our examples look at private companies. I know that all entities need to provide disclosures about temporary differences in tax carryforwards but, usually, the requirements for public companies are different than those for private nonpublic entities or private entities. Could you touch on that a little bit?

**Mr. Madray**

Sure, and you are right. In this specific area related to temporary differences in tax carryforwards, the required information in the disclosure will vary, depending on whether the entity is a public entity or a nonpublic entity. Essentially, a nonpublic entity would need to identify each category of significant temporary

differences in tax carryforwards, but nonpublic entities are *not* required to disclose numerical estimates of the tax effects of each of those categories, where public companies *are* required to make those numerical estimates. Here, again, the requirement is each category of significant temporary difference. Entities can, basically, determine the individual disclosure items by looking at their financial statement captions, like property, plant, and equipment; or by subgroup, like tractors, trailers, terminals for a trucking company or something like that; or by individual asset.

Now, again, even though the word *significant* is used here, the FASB ASC Master Glossary does not define the term *significant* as it is used here in Topic 740. Now, for public companies, the SEC staff has indicated that to meet this requirement, public companies would need to disclose all components that equal or exceed 5% of the gross deferred tax asset or deferred tax liability. Again, that is an SEC staff requirement, but nonpublic companies would probably want to look to that to make some type of quantitative judgment about significance, in terms of disclosing the significant temporary differences in tax carryforwards. So, a key area there where we have some differences between public company requirements and nonpublic company requirements in the disclosures.

#### **Ms. Grove Casey**

Moving on to some income statement-related disclosures. Can you discuss the requirements related to the significant components of income tax expense?

#### **Mr. Madray**

Sure. As we mentioned earlier, entities would need to disclose the significant components of tax expense that are related to income from continuing operations for each year that an income statement is provided. This particular disclosure sometimes is provided on the face of the income statement but, again, depending on the amount and detail, could be in the notes to the financial statements. This next slide shows some examples of what would be considered components of the income tax expense that again, if significant, would need to be disclosed separately. For example, the current tax expense or tax benefit separately from the deferred tax expense or tax benefit. Other examples: investment tax credits, grants from government bodies that have been recognized as a reduction of income tax expense, tax benefits of operating loss carryforwards, tax expense

related to apportionment of certain tax benefits that are related to contributed capital, and adjustments of deferred tax liabilities or assets for any enacted changes in tax laws or rates or changes in the tax status of the entity. Then, finally, adjustments of the beginning-of-year balance of the valuation allowance where a change in circumstances caused a change in judgment about the realizability of the related deferred tax asset in future years.

We have an example of this type of disclosure. This one is actually taken from the company that we would all know, Best Buy. In their income tax note, as you see on this slide related to the years 2019, 2020, and 2021, they disclose in this table the earnings before income tax expense by jurisdiction. They break it down into U.S., and then foreign. We get to the earnings before income tax and, then, “The income tax expense or benefit was comprised of the following,” and they break it down, again, between federal, state, and foreign, in terms of the current expense. Then, the deferred expense or benefit—same thing—federal, state, and foreign, to get to the overall income tax expense in this example of \$579 million, \$452 million, and \$424 million.

So, again, these are examples of things, but it will depend on the entity, in terms of what types of components will need to be disclosed, based on what they consider to be the significant makeup of that. But I think, in most cases, we would at least see a breakdown of the current tax expense benefit and the deferred tax expense benefit. Now, importantly, in the example that we just looked at, everything is broken down by tax jurisdiction. There is no current requirement for nonpublic companies to break that down by jurisdiction. They certainly can if they choose to, but there is no requirement at this time for nonpublic companies to separate it by jurisdiction as we saw in that Best Buy example.

#### **Ms. Grove Casey**

I believe the rate reconciliation is another area where there are different requirements for public and nonpublic entities. Could you discuss that a little bit?

#### **Mr. Madray**

Sure. Of course, all entities are required to provide some disclosure about the difference between the income tax expense recognized in the financial statements versus the amount expected if the tax

expense were calculated by simply applying the statutory income tax rates to the net income before taxes. All entities are required to provide information about the nature and the effect of any significant item that makes it difficult to compare the amount of the income tax expense recognized in the financial statements. A nonpublic company specifically needs to disclose the nature of each significant reconciling item but is not required to present a numerical reconciliation. That is the big difference between public and nonpublic companies with regard to the rate reconciliation disclosure.

Nonpublic companies will provide information about the main reconciliation items that we have on this next slide. The reconciling items between the amount of income tax expense recognized in the income statement related to income from continuing operations and the amount of income tax expense that is calculated as we see on the slide here, simply taking pre-tax income from continuing operations and multiplying it by the domestic federal statutory income tax rate. So, again, public companies are going to have to go further to actually provide a numerical reconciliation but, private companies, again, while they do have the requirement to disclose this information, it is more broad.

The next slide is an example from a private company financial statement, a specific disclosure related to the rate reconciliation. As we see on this slide, the following is reconciliation of the statutory federal income tax rate applied to pre-tax accounting income with the income tax provision that is attributable to continuing operations in the statements of income. In the two years presented here, we have income tax expense at the statutory rate which, in this case, is 22.08% and 15%, then an increase or decrease resulting from, in this case: state income taxes net of the federal income tax benefit, temporary differences, permanent differences, and deferred income tax adjustment, to get to the provision for federal income tax which is provided in the actual income statement for this company.

So, as you said, there are differences between public and nonpublic companies. The requirement is there for all entities but the public companies, again, would have to provide a numerical reconciliation of these items between the actual income tax expected to be paid versus what is provided for in the provision on the income statement.

## Ms. Grove Casey

Let's move on to unrecognized tax benefits. Could you discuss the requirements there? Because I'm sure that they are in some ways similar, but probably tweaked a little bit compared to recognized tax benefits.

## Mr. Madray

Oh, yes, absolutely. This is that area that, not too many years ago, the FASB began requiring this type of information in the disclosures. Essentially, all entities need to provide the information that we see on this next slide regarding unrecognized tax benefits at the end of each annual reporting period. You see the requirements: the amount of interest and penalties that are recognized in the income statement and balance sheet, respectively; the following items that are specific to those tax positions where it is reasonable to expect that the amount of the unrecognized tax benefit could change significantly, either way, within twelve months of the reporting date, including the reason why the position is uncertain; the type of event that could lead to a change in that amount in the next twelve months; the approximate range of the change that is deemed reasonably possible, or a statement that an estimate is not determinable; and finally, a statement describing the tax years that are still open for audit by major tax authorities.

The next slide has an example of this disclosure for uncertain tax positions. It says the company has approximately \$1.9 million and \$1.1 million accrued for interest and penalties, respectively, in the consolidated balance sheets, and recorded \$800,000 and \$600,000 in interest in penalties during 2020 and 2019 in the statement of income. Interest and penalties related to unrecognized tax benefits are recorded in the provision for income taxes. Unrecognized tax benefits are not expected to significantly change within the next 12 months. And then, the disclosure related to the years that are still open to audit by tax authorities, ending up with, "Adequate amounts are established for any adjustments that could result from examinations for tax years after 2015; however, an unfavorable settlement of a particular issue would require use of the company's cash and cash equivalents."

Again, these are all related to the unrecognized tax benefits, which is the fancy way of saying that these are aggressive positions that have been taken in the tax return and we are required to record certain liabilities



related to that. These are the disclosures specific to those types of unrecognized tax benefits that we would find in the financial statements.

**Ms. Grove Casey**

Finally, what other disclosures are required related to income taxes?

**Mr. Madray**

Great question, because there are still—even though we have covered the major requirements in Topic 740—there are a few others that are “if applicable” and come from outside of Topic 740. One of those relates to consolidated tax returns. If a reporting entity is a member of a tax group that files a consolidated tax return but they issue separate financial statements, then the entity would need to provide the information we see on this slide related to its separate financial statements. First, the aggregate, current, and deferred income tax expense for each income statement that is presented; the amounts that are owed to, or by, the affiliated entities for taxes as of the date of each balance sheet that is presented; and finally, the method for allocating the consolidated current and deferred tax expense between the members of the tax group, as well as a description, in effect, of changes to that method if there has been a change in that method during the years presented.

We have an example of this on the next slide where the company is a member of a tax group that files a consolidated tax return. Under the separate return method, the company is assumed to file a separate return with the taxing authority, thereby reporting its taxable income or loss, and paying applicable tax. Therefore, it would be possible that the company could recognize a loss or a credit carryforward, even though there is no carryforward on a consolidated basis. It goes further and [provides] the allocation of the income tax expense for the three years presented here; the current income tax expense; the deferred income tax expense or benefit; and then, the net total income tax expense. Finally, the following amounts are owed to, or by, the company for taxes as of December 31st so we have the \$15 million, \$89 million, and \$13 million.

One side note here to point out is, the reporting entity does not have to allocate the consolidated amounts of current and deferred tax expense to a legal entity that is not subject to tax, but it can elect to do so on an entity-

by-entity basis. So, if part of the consolidated group is an S corp, or partnership, or something that would not be subject to income tax, a decision can be made of whether or not to allocate the income tax expense, current and deferred portions, to that particular entity. If there is an entity that is not subject to tax, it is also a *disregarded entity* by the taxing authority. If they make an election under Topic 740 to include allocated amounts of current and deferred tax expense in the separately issued financial statements, they need to disclose the fact that they are doing that, and then, also, provide the disclosures that we just saw in the previous example related to that. So, there are some choices that can be made there in terms of entities that make up the consolidated group.

Another area of disclosure that is a bit beyond what we have talked about already has to do with some income tax accounting policies. Entities are allowed choices, in certain cases, between different income tax accounting policies and, in that case, the policies that are elected and applied by the entity need to be disclosed. You see on the next slide that they typically fall into two categories: classification of interest and penalties, and the method of recognition of investment tax credits. With regard to interest and penalties, entities can elect to present the amount of interest that they recognize under Topic 740, related to an underpayment of income tax, in the income statement as either part of the income tax expense or separately as interest expense.

Now, as a side note, most public companies include interest and penalties in income tax expense. Again, since that choice is made, that has to be disclosed somewhere—either in the significant accounting policy note or, in some cases, in the income tax note—based on the amount of interest, penalties, and other income tax-related amounts that are recognized in the financial statements. So, we have an example here on this slide of that policy. In this example, our policy is to classify interest and penalties related to unrecognized tax benefits, if and when required, as a component of income tax provision or benefit in the consolidated statements of operations. They have made a policy election to treat the global intangible low-taxed income (GILTI) tax as a period expense, which is another requirement related to that policy.

I'll also mention investment tax credits. For tax purposes, an investment tax credit can be used to reduce current taxes payable, or can be carried back or carried forward. Under Topic 740, an entity can elect one of

two methods to recognize the tax benefits from investment tax credits in the financial statements. The two approaches or methods are called the *deferral method* and the *flow-through method*.

Under the deferral method, the company recognizes cost savings gradually from the tax credit. In other words, the investment tax credit is accounted for as a reduction to the acquired asset that gave rise to the credit. Then, the credit is amortized over the useful life of the asset. The amortization would be a reduction to income tax expense.

Under the flow-through method, the entity would recognize the cost savings immediately from the investment tax credit, so the entire investment tax credit is accounted for as a reduction in income tax expense in the year that the asset is acquired. Using that method is similar to the treatment of a tax credit for tax purposes. Typically, a temporary difference would not exist when an entity elects to use that flow-through method.

However, in Topic 740, the deferral method is identified as the preferable approach for financial reporting purposes but, again, either approach can be used. In this next slide, we have examples of each of these. The first one is the flow-through method. The company uses the flow-through method to account for investment tax credits. Under this method, the investment tax credits are recognized as a reduction to income tax expense.

In the second example, investment tax credits are accounted for under the cost reduction method, whereby they are netted against the expense, or property and equipment, to which they relate. Investment tax credits are recorded when the qualifying expenditures have been incurred and, if it is more likely than not, the tax credits will be realized.

One final area to mention—and I think we have covered just about everything—is we can't forget that under Topic 275, *Risks and Uncertainties*, there is some disclosure guidance that would be incremental to what is provided in Topic 740 specific to estimates, that would meet the conditions for disclosure under Topic 275. So, that is a subjective determination in terms of what would need to be disclosed there. On this next slide, we have an example of what that might look like for a company that had determined that there were some things that met the requirements under Topic 275.

In this example, the entity has recorded a deferred tax asset of \$4.8 million, reflecting the benefit of \$12 million in loss carryforwards, which expire in varying amounts. Realization is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced. Again, that is not a disclosure that comes from a requirement in Topic 740. That is a disclosure made because a determination was made under Topic 275 that it met the conditions for disclosure of certain uncertainties, in this case related to the deferred tax asset and the estimates related to that.

I think that covers everything. As we said in the beginning, it is an area where there are some problems from time to time—folks omit or don't quite get the disclosures right related to income taxes. So, hopefully, this has been helpful to our folks and we will get back together again if we need to and go further. Certainly, when the FASB finishes the work on that proposal, we will be talking about those changes. But again, that is, I suspect, another year or so away in the future.



## SUPPLEMENTAL MATERIALS

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### ASC 740, *Income Taxes*: Disclosure Requirements

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#### Overview

The information provided by the recognized amounts and related descriptions in the financial statements is fundamental to a user's decision making, but the information that can be provided in that form is inherently limited. Consequently, notes to financial statements provide relevant information that is not provided on the face of the financial statements. Notes provide information that explains specific line items on the face of the financial statements. Additionally, notes provide information about past events and current circumstances and conditions that have not been recognized but will, or may, affect an entity's future cash flows. Financial Accounting Standards Board *Accounting Standards Codification* (FASB ASC) 740-10-50, *Income Taxes—Overall—Disclosure*, is the source of guidance on the disclosures related to income taxes in the financial statements of all entities.

**Observation:** In 2016, the FASB issued a proposed Accounting Standards Update (ASU), *Income Taxes (Topic 740): Disclosure Framework—Changes to the Disclosure Requirements for Income Taxes*, that set forth enhanced disclosure requirements for income taxes. After passage of the *Tax Cuts and Jobs Act* (TCJA) in December 2017, the FASB, in 2019, issued a revised proposed ASU. The revised proposed ASU would (1) remove disclosures that no longer are considered cost beneficial or relevant, and (2) add disclosure requirements identified as relevant to financial statement users. The FASB continues to work on this project.

#### Balance Sheet Disclosures

##### Deferred Taxes

Reporting entities should disclose separately three components of the net deferred tax balance recognized in a balance sheet:

- The total amount of deferred tax liabilities determined according to FASB ASC 740-10-30-5(b)

- The total amount of deferred tax assets determined according to FASB ASC 740-10-30-5(c) and 30-5(d)
- The total amount of valuation allowance on deferred tax assets measured pursuant to FASB ASC 740-10-30-5(e)

A reporting entity also should disclose the net change in the valuation allowance on deferred tax assets during the reporting year. In addition, FASB ASC 740-10-50-8 requires the types of temporary differences that give rise to significant portions of a deferred tax asset or liability to be disclosed. However, it does not prescribe how the differences should be disclosed.

The following is an example of these disclosure requirements:

#### Note 1—Accounting Policies

##### Income Taxes

Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes. Deferred taxes are recognized for differences between the basis of assets and liabilities for financial statement and income tax purposes. The differences relate primarily to depreciable assets (use of different depreciation methods and lives for financial statement and income tax purposes), allowance for doubtful receivables (deductible for financial statement purposes but not for income tax purposes), and profit on installment sales (deferred for income tax purposes but recognized for financial statement purposes). The deferred tax assets and liabilities represent the future tax return consequences of those differences, which will either be deductible or taxable when the assets and liabilities are recovered or settled. Deferred taxes also are recognized for operating losses and tax credits that are available to offset future taxable income.

#### Note 16—Income Taxes

The Company's total deferred tax liabilities, deferred tax assets, and deferred tax asset valuation allowances at December 31 were as follows (in thousands):

	2020	2019
Deferred tax assets:		
Total deferred tax assets	46,138	37,164
Less: Valuation allowance	(37,856)	(30,363)
Net deferred tax assets	8,282	6,801
Deferred tax liabilities:		
Total deferred tax liabilities	(8,056)	(6,596)
Net deferred tax assets (liabilities)	<u>\$ 226</u>	<u>\$ 205</u>

As of December 31, 2020, the Company has a valuation allowance of approximately \$37,856,000 against all net domestic deferred tax assets, for which realization cannot be considered more likely than not at this time. Management assesses the need for the valuation allowance on a quarterly basis. In assessing the need for a valuation allowance, the Company considers all positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies, and past financial performance. While recent positive operating results, as a result of increases in bookings, caused the Company to be in a cumulative income position as of December 31, 2020, the Company faces uncertainties in forecasting its operating results due to the continued impact of the COVID-19 pandemic on the Company's supply chain, certain process issues with the production of Advanced Products, and the unpredictability in certain markets. This operating uncertainty also makes it difficult to predict the availability and utilization of tax benefits over the next several years. As a result, management has concluded, at this time, it is more likely than not that the Company's net domestic deferred tax assets will not be realized, and a full valuation allowance against all net domestic deferred tax assets is still warranted as of December 31, 2020. The valuation allowance against these deferred tax assets may require adjustment in the future based on changes in the mix of temporary differences, changes in tax laws, and operating performance. If the positive quarterly earnings and increases in bookings continue, and the Company's concerns about industry uncertainty and world events, including the impact of the COVID-19 pandemic on the Company's supply chain, and process issues with the production of Advanced Products are resolved, and the amount of tax benefits the Company is able to utilize to the point that the Company believes future taxable income can be more reliably forecasted, the Company may release all or a portion of the valuation allowance in the near term.

Certain state tax credits, though, will likely never be released by the valuation allowance. If and when the Company determines the valuation allowance should be released (i.e., reduced), the adjustment would result in a tax benefit reported in that period's Consolidated Statements of Operations, the effect of which would be an increase in reported net income.

### Operating Losses and Tax Credit Carryforwards

A reporting entity should disclose the following information related to operating losses and tax credit carryforwards:

- The amounts of operating losses and tax credit carryforwards taken on the tax returns and the dates on which these amounts expire
- The amount of any valuation allowance (or portion thereof) on deferred tax assets for which the reporting entity will credit any future recognized tax benefits to shareholders' equity (e.g., a deferred tax asset relating to a net unrealized loss on available-for-sale securities)

The following is an example of a private company financial statement disclosure regarding operating losses and tax carryforwards:

### Note 8—Income Taxes

At June 30, 2019 and 2018, the Company has net operating losses of \$-0- and \$174,000, respectively, available for carryforward to future years. These operating losses begin to expire in June 2030.

### Change in Tax Status

If a reporting entity changes its tax status after the end of the reporting year, but prior to the date that the financial statements are available to be issued (i.e., the change qualifies as a subsequent event according to FASB ASC 855, *Subsequent Events*), then two items should be disclosed in the financial statements:

- The change in the tax status that occurred after year-end
- The effect of the change on the financial statements, if material

The following is an example of this disclosure:

### Note 19—Income Taxes

On January 2, 2021, the Company filed an election with the Internal Revenue Service, electing to be treated as a

taxable corporation for U.S. federal income tax purposes effective January 2, 2021. See Note 21, *Subsequent Events*, for additional disclosures regarding the election.

## Note 21—Subsequent Events

### Tax Election

As discussed in Note 19, *Income Taxes*, on January 2, 2021, the Company filed an election with the Internal Revenue Service electing to be treated as a taxable corporation for U.S. federal income tax purposes, effective January 2, 2021.

### Temporary Differences and Tax Carryforwards

All entities should provide additional disclosures about temporary differences and tax carryforwards. The required information varies, however, for public and nonpublic entities. A nonpublic entity must identify each category of significant temporary differences and tax carryforwards. A nonpublic entity is not required, however, to disclose numerical estimates of the tax effects of each category. An entity can determine individual disclosure items by looking at financial statement captions (e.g., property, plant, and equipment), by subgroup (e.g., tractors, trailers, and terminals for a trucking company), or individual asset.

**Practice Note:** The FASB ASC Master Glossary does not define “significant,” as used in FASB ASC 740-10-50-6. However, the SEC staff has indicated that, to meet this requirement, public entities should disclose all components that equal or exceed five percent of the gross deferred tax asset or deferred tax liability.

### Income Statement

### Significant Components of Income Tax Expense

Reporting entities should disclose the significant components of tax expense that are related to income from continuing operations for each year that an income statement is provided. These disclosures may be provided in either the income statement or the notes to the financial statements.

The following are examples of components that, if significant, should be disclosed:

- Current tax expense or benefit
- Deferred tax expense or benefit (without the effects of any of the other components listed below)
- Investment tax credits

- Grants from government bodies that have been recognized as a reduction of income tax expense
- Tax benefits of operating loss carryforwards
- Tax expense due to the apportionment of certain tax benefits to contributed capital
- Adjustments of a deferred tax liability or asset for enacted changes in tax laws, rates, or a change in the tax status of the entity
- Adjustments of the beginning-of-the-year balance of a valuation allowance because of a change in circumstances that causes a change in judgment about the realizability of the related deferred tax asset in future years. The following note is an example of this disclosure from Best Buy Co., Inc.

## Note 11—Income Taxes

Earnings before income tax expense by jurisdiction were as follows (\$ in millions):

	2021	2020	2019
United States	\$2,203	\$1,704	\$1,574
Foreign	<u>174</u>	<u>289</u>	<u>314</u>
Earnings before income tax	\$2,377	\$1,993	\$1,888
Income tax expense (benefit) was comprised of the following (\$ in millions):			
	2021	2020	2019
Current:			
Federal	\$447	\$261	\$275
State	117	73	75
Foreign	<u>51</u>	<u>48</u>	<u>64</u>
	615	382	414
Deferred:			
Federal	(25)	56	4
State	(16)	8	-
Foreign	<u>5</u>	<u>6</u>	<u>6</u>
	<u>(36)</u>	<u>70</u>	<u>10</u>
Income tax expense	\$579	\$452	\$424

**Practice Note:** Disclosure by jurisdiction, as presented above, is not required for non-public entities.

### Rate Reconciliation

All entities should provide disclosures about the difference between income tax expense recognized in the financial statements and the amount expected if tax expense were calculated by applying the statutory income tax rates to net income before taxes. The required information varies, however, for public and nonpublic entities.

All entities should provide information about the nature and effect of any significant item that makes it difficult to compare the amount of income tax expense recognized in the financial statements across all the periods presented. A nonpublic entity must disclose the nature of each significant reconciling item, but is not required to present a numerical reconciliation. Further, nonpublic entities should provide information about the main reconciling items between:

- The amount of income tax expense recognized in its income statement that is related to income from continuing operations; and
- The amount of income tax expense calculated as follows:

Pretax income from continuing operations

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Domestic federal statutory income tax rates

The following is an excerpt of a typical private company financial statement disclosure for a reconciliation of the company's statutory rate to its effective tax rate.

### Note 6—Income Taxes

The following is a reconciliation of the statutory federal income tax rate applied to pretax accounting income with the income tax provision attributable to continuing operations in the statements of income:

	<b><u>Year Ended December 31</u></b>	
	<b><u>2014</u></b>	<b><u>2013</u></b>
Income Tax Expense at the Statutory Rate (22.08%/15.00%)	\$25,433	\$4,055
Increase (Decrease) Resulting from:		
State Income Taxes, Net of Federal Income Tax Benefit	(2,140)	(308)

Temporary Differences	(2,145)	411
Permanent differences	621	414
Deferred Income Tax Adjustment	<u>2,429</u>	<u>(685)</u>
Provision for Federal Income Tax	\$24,198	\$3,887

### Unrecognized Tax Benefits

All reporting entities should provide the following information regarding unrecognized tax benefits at the end of each annual reporting period presented:

- Amount of interest and penalties recognized in the income statement and balance sheet, respectively
- The following items specific to those tax positions for which it is reasonable to expect that the amount of unrecognized tax benefits may change significantly, either positively or negatively, within 12 months of the reporting date:
  - The reason why the position is uncertain
  - The type of event that could lead to a change in the amount within 12 months
  - The approximate range of the change deemed reasonably possible, or a statement that such an estimate is indeterminable
  - A statement describing the tax years still open for audit by major tax authorities

The following is an example of this disclosure:

### Note 13—Income Taxes

#### Uncertain Tax Positions

The Company has approximately \$1.9 million and \$1.1 million accrued for interest and penalties as of December 31, 2020 and December 31, 2019, respectively, in the Consolidated Balance Sheets and recorded \$0.8 million and \$0.6 million in interest and penalties during 2020 and 2019, respectively, in the Consolidated Statements of Income. Interest and penalties related to unrecognized tax benefits are recorded in "Provision for income taxes" on the Consolidated Statements of Income.

Unrecognized tax benefits are not expected to significantly change within the next 12 months.

Generally, a number of years may elapse before a tax reporting year is audited and finally resolved. With few exceptions, the Company is no longer subject to U.S. federal, state, or local examinations by tax authorities before 2015. While it is often difficult to predict the final outcome or the timing of or resolution of a particular tax matter, the Company does not anticipate any adjustments resulting from U.S. federal, state, or foreign tax audits that would result in a material change to the financial condition or results of operations. Adequate amounts are established for any adjustments that may result from examinations for tax years after 2015. However, an unfavorable settlement of a particular issue would require use of the Company's cash and cash equivalents.

## Other Disclosures

### Consolidated Tax Return

If an entity is a member of a tax group that files a consolidated tax return and issues separate financial statements, then the entity must provide the following information in its separate financial statements:

- The aggregate current and deferred income tax expense for each income statement presented
- The amounts owed to or by affiliated entities for taxes as of the date of each balance sheet presented
- The method for allocating the consolidated current and deferred tax expense between the members of the tax group, and the description and effect of changes to this method, if any, during the years presented

The following is an example of this disclosure.

### Note 9—Income Taxes

The Company is a member of a tax group that files a consolidated tax return and uses the separate return method to allocate the consolidated amount of current and deferred tax expense among the group members. Under the separate return method, the Company is assumed to file a separate return with the taxing authority, thereby reporting its taxable income or loss and paying the applicable tax to or receiving the appropriate refund from

the parent. Thus, it is possible that the Company could recognize a loss or credit carryforward, even though there is no carryforward on a consolidated basis. Additionally, when the tax law in the jurisdiction provides for the carryback of losses, the Company could reflect the carryback of a current-year loss against prior taxable income even though the consolidated group had losses. Allocated income tax expense (benefit) was comprised of the following (\$ in millions):

	<u>2021</u>	<u>2020</u>	<u>2019</u>
Current:	615	382	414
Deferred:	<u>(36)</u>	<u>70</u>	<u>10</u>
Income tax expense	\$579	\$452	\$424

The following amounts are owed to (or by) the Company for taxes as of December 31 (\$ in millions):

2019	\$ 15
2020	\$(89)
2021	\$ 13

**Observation:** A reporting entity does not have to allocate consolidated amounts of current and deferred tax expense to a legal entity that is not subject to tax, but it may elect to do so on an entity-by-entity basis. If an entity that is not subject to tax and that is also disregarded by the taxing authority makes the election under FASB ASC 740-10-30-27A to include allocated amounts of current and deferred tax expense in its separately issued financial statements, it must disclose this fact. In addition, the entity must provide the disclosures described above.

### Income Tax Accounting Policies

A reporting entity is sometimes allowed a choice between several available tax accounting policies. The policies elected and applied by the entity should be disclosed. These choices generally relate to:

- The classification of interest and penalties
- The method of recognition of investment tax credits

### Interest and Penalties

A reporting entity may elect to present the amount of interest it recognizes pursuant to FASB ASC 740-10-



25-56 related to an underpayment of income taxes in its income statement as either income tax expense or interest expense.

**Observation:** Most public reporting entities include interest and penalties in income tax expense (i.e., provision for income taxes). Some entities disclose their policy in the Summary of Significant Accounting Policies note; other entities disclose their policy in the Income Taxes note for context on the amount of interest, penalties, and other income tax-related amounts recognized in the financial statements.

The following is an example of this disclosure from Seachange International, Inc.:

#### **Note 2—Summary of Significant Accounting Policies**

Our policy is to classify interest and penalties related to unrecognized tax benefits, if and when required, as a component of income tax provision (benefit), in our consolidated statements of operations and comprehensive loss. We have made a policy election to treat the global intangible low-taxed income (“GILTI”) tax as a period expense.

#### **Investment Tax Credits**

For tax purposes, an investment tax credit can be used to reduce the current taxes payable by an entity, or it can be carried back or forward. As described in FASB ASC 740-10-25-46, a reporting entity may elect one of two methods to recognize the tax benefits from investment tax credits in its financial statements. The two acceptable approaches are the deferral method and the flow-through method. Under the deferral method, an entity recognizes the cost savings gradually from the tax credit. More specifically, the investment tax credit is accounted for as a reduction to the acquired asset that gave rise to the credit. Then, the credit is amortized over the useful life of the asset. The amortization is a reduction to income tax expense. A temporary difference arises when a company elects to use the deferral method for investment tax credits.

Under the flow-through method, an entity recognizes the cost savings immediately from the tax credit. The entire investment tax credit is accounted for as a reduction in income tax expense in the year the asset is acquired. The treatment of the tax credit using the flow-through method is similar to the treatment of the tax

credit for tax purposes. Therefore, a temporary difference does not exist when an entity elects to use the flow-through method. As noted in FASB ASC 740-10-25-46, the deferral method is the preferable approach for financial reporting purposes.

The following examples illustrate this disclosure requirement:

The Company uses the flow-through method to account for investment tax credits. Under this method, the investment tax credits are recognized as a reduction to income tax expense.

*or*

Investment tax credits are accounted for under the cost reduction method whereby they are netted against the expense or property and equipment to which they relate. Investment tax credits are recorded when the qualifying expenditures have been incurred and if it is more likely than not that the tax credits will be realized.

#### **Risks and Uncertainties**

FASB ASC 275, *Risks and Uncertainties*, provides disclosure guidance incremental to that provided in FASB ASC 740, specific to estimates that satisfy certain conditions. The following is an illustration of this disclosure:

The entity has recorded a deferred tax asset of \$4.8 million reflecting the benefit of \$12 million in loss carryforwards, which expire in varying amounts between 19X5 and 19X7. Realization is dependent on generating sufficient taxable income prior to expiration of the loss carryforwards. Although realization is not assured, management believes it is more likely than not that all of the deferred tax asset will be realized. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period are reduced.

## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Describe the disclosure requirements related to the net deferred tax balance recognized in a balance sheet.
2. Discuss the items that should be disclosed in the financial statements if a reporting entity changes its tax status after the end of the reporting year, but prior to the date that the financial statements are available to be issued.
3. Explain how a reporting entity allocates consolidated amounts of current and deferred tax expense to a legal entity that is not subject to tax.

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**B. Suggested Answers to Discussion Problems**

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1. Reporting entities should disclose separately three components of the net deferred tax balance recognized in a balance sheet:

- The total amount of deferred tax liabilities determined according to FASB ASC 740-10-30-5(b)
- The total amount of deferred tax assets determined according to FASB ASC 740-10-30-5(c) and 30-5(d)
- The total amount of valuation allowance on deferred tax assets measured pursuant to FASB ASC 740-10-30-5(e)

A reporting entity also should disclose the net change in the valuation allowance on deferred tax assets during the reporting year. In addition, FASB ASC 740-10-50-8 requires the types of temporary differences that give rise to significant portions of a deferred tax asset or liability to be disclosed.

2. If a reporting entity changes its tax status after the end of the reporting year, but prior to the date that the financial statements are available to be issued (i.e., the change qualifies as a subsequent event according to FASB ASC 855, Subsequent Events), then two items should be disclosed in the financial statements:

- The change in the tax status that occurred after year-end
- The effect of the change on the financial statements, if material

3. A reporting entity does not have to allocate consolidated amounts of current and deferred tax expense to a legal entity that is not subject to tax, but it may elect to do so on an entity-by-entity basis. If an entity that is not subject to tax and that is also disregarded by the taxing authority makes the election under FASB ASC 740-10-30-27A to include allocated amounts of current and deferred tax expense in its separately issued financial statements, it must disclose this fact. In addition, the entity must provide the same disclosures as those of an entity that is a member of a tax group that files a consolidated tax return and issues separate financial statements.

## PART 2. AUDITING

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### Recent PCAOB Auditing Standards Activity

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The mission of the PCAOB is to oversee the audits of public companies and SEC-registered brokers and dealers, in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. While initially the PCAOB adopted the standards issued by the Auditing Standards Board, known as GAAS, it has continued to refine the standards to focus on those issues of primary importance to the PCAOB's mission.

For more on recent activity from the PCAOB on updating the Interim Standards, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

#### Ms. Grove Casey

So today we want to talk a little bit about the PCAOB and, to begin with, what is the general role of the PCAOB?

#### Ms. Louis

Well, the PCAOB, when it was originally formed, it had a mission to oversee the audits that are done of public companies, [and] SEC-registered brokers-dealers, with the goal, ultimately, to help further protect investors and protect the public's interest—because they are focused on the independent audit reports and to make sure that they are informative and accurate. So, from that, they created some oversight mechanisms and part of those mechanisms is to do inspections of these registered public accounting firms, to take enforcement action, but also to set standards as they figure out what are the standards that need to be in place that are most important towards their specific mission in dealing with these SEC filers.

#### Ms. Grove Casey

Let's talk a little bit about one of the PCAOB's most recently released audit standards. Could you talk about that a little?

#### Ms. Louis

So, one of their recently released ones relates to the requirements for a lead auditor as they are using the work of other auditors. What you find is we now have more global operations for a variety of organizations out there that often have to involve multiple accounting firms as they are looking at completing these audits for these larger companies.

What they want to do is to improve the quality of the audits that relate to when there are other auditors besides the lead auditor, the lead auditor has to

supervise. And, often, looking at, what are the responsibilities that you have? And could there be some times—as there are—that sometimes we know that there is another audit firm involved because they are a *referred-to* auditor; they reference them. In other cases, we do not have a referred-to auditor. [They are] looking at what should be the responsibilities when you have a referred-to auditor versus not. That is the challenge of ensuring that there is proper communication to the lead auditors but, also, ensuring that there is no misunderstanding related to those other parties that are involved, as well.

#### Ms. Grove Casey

What are some of the primary ways that this new auditing standard will improve the quality of audits?

#### Ms. Louis

Well, part of it is going to just put greater attention to the fact that there does need to be improved communication between the lead auditor and these other auditors to help prevent or detect any type of deficiencies that might exist in the overall quality of the audit. That is part of the main goal, to have a risk-based approach to supervising other auditors and to require certain communications, as we look at the planning and the completion process of the audit, to ensure that we are increasing quality.

#### Ms. Grove Casey

Can you give me some specific examples of what will be changed with this standard?

#### Ms. Louis

A large part of it does deal with, for example, the engagement partner that would be a part of the lead auditor. They need to determine whether or not their

participation in the audit is sufficient to carry out the responsibilities of a lead auditor and to report underneath that umbrella.

Part of it would be to determine whether or not, also, as we think about engagement quality control reviewers, when is it that the engagement quality control reviewer should be involved in the process? When is it that I'm the actual lead auditor? When should I have engagement quality control? Also, to determine the compliance for the engagement as a whole with things like independence and ethics. Understanding when I have another auditor involved, what is their knowledge about these requirements? What are their experiences in applying these independence and ethics rules? Potentially, getting some sort of written affirmation regarding this other auditor's policies and procedures related to those requirements, and to particularly focus on when I'm not a referred-to auditor. I'm the component auditor where the lead auditor, in essence, is taking ownership and responsibility for my quality and my supervision.

Part of that is going to be, what are we doing, and asking for these written acknowledgements about independence [and] ethics. Also, in general, what do we know about their skills, their knowledge [and] experience, in order to perform these different types of tasks that are now being allocated and delegated to these other auditors? Oftentimes, we may have multi-tiered audits where we have the lead auditor and then there is another auditor, and then there may be another auditor below that as there is some outsourcing that might occur in these engagements, and to clarify who is accountable for that quality when you have that multi-tiered approach to those circumstances.

#### **Ms. Grove Casey**

Are there ever any situations where the lead auditor does not supervise the work performed by another auditor?

#### **Ms. Louis**

There are. Where the lead auditor—as we think about dividing responsibility—there can be divided responsibility for the portion of an audit where the audit firm, ultimately, is the referred-to auditor. So, therefore, the lead auditor is not supervising the work performed by that firm because we are, in our report, going to say, “There is a portion of this audit that was performed by somebody else.”

What happens in this new standard is it is going to require in these situations that the lead auditor, though, determine that audit procedures were performed regarding the combination or consolidation of these financial statements, including the business units or the components that were audited by this referred-to auditor. And to, also, have the lead auditor get a written representation from the referred-to auditor that says they are independent, they are properly licensed. The lead auditor would say in their report what is the magnitude of the portion of this audit that was handled by this separate referred-to auditor. What will happen is when you are a referred-to auditor, that will mean that they are saying, “I’m not taking ownership over your quality control.” Whereas, if you are not the referred-to auditor, then [they] are.

#### **Ms. Grove Casey**

What is the general nature of the PCAOB’s current standard-setting agenda, and how do they establish that agenda?

#### **Ms. Louis**

As they decide what they want to focus on, it all goes back to their overarching mission which is to advance audit quality. The goal of that is to protect the interests of investors [and] to further public interest, as we have these informative, accurate audit reports. Their approach, then, is based on the standards, the interpretations, the guidance that they are putting out there. What may happen is that there could be an issue that just bubbles up, that becomes a frequently asked question, and that might result in something coming up on the standard-setting agenda. For example, we might have something related to, “What are my responsibilities as an auditor related to going concern?” since there might be more organizations that have these going concern disclosures in their financial statements.

Also, just modernizing things as we think about bringing in the effect of maybe some technological changes, or how the practice of the audit profession might evolve over the course of time. There also would be a need, then, to say, “Well, there is something that already exists, but let’s modernize it. Let’s bring it up to date.” What they will do is they will go through and research certain topics and try to decide a level of prioritization of what do we need to advance and put on the fast track, and what is it that we can take our time on and slowly do the research, and do the necessary work in order to actually bring things up to vote? So, it

is really a part of the PCAOB staff working with a variety of stakeholders to determine, what is a reasonable timeline for the completion of these different projects? And to be more responsive in what they are hearing from the SEC, from investors, from PCAOB advisory groups, and from their own personal observations, as well.

**Ms. Grove Casey**

It is my understanding that there is a current project related to quality control. Let's talk a little bit about what the nature of that project is. I know other areas of the AICPA have been looking at quality control for quite a while.

**Ms. Louis**

Exactly. Both internationally and here in the U.S., the sense of revisiting the quality control standards that already exist. It is not that there aren't standards, but how should they be revised? How should they be enhanced as it relates to, once again, improving the quality of not just audits, but other engagements that also might be done underneath some set of professional standards—whether that is an examination, whether it is an agreed-upon procedures engagement.

The goal, then, is that as we are looking [at] these quality control systems, it is to provide reasonable assurance that a CPA firm and its personnel can actually comply with all the relevant professional, technical, and ethical standards. To have some level of quality that we can assume exists, in principle, across all of these different registered firms that are out there, as we think about their systems of quality control.

**Ms. Grove Casey**

What resources have been considered when they have been drafting these quality control standards?

**Ms. Louis**

They did take into account what the International Auditing and Assurance Standards Board (IAASB) did as they created their modernized standards for what they are now calling quality management (as opposed to quality control). Those standards, internationally, were effective December 15th, 2022. And through those standards, they looked at the complexity of our audit environment and the fact that it is more global, and the fact that there are growing expectations from a variety of stakeholders to have quality management

systems that are both what they call proactive, [and] also adaptable. *Adaptable* meaning that it can be a risk-based approach. Depending on the nature, the size, the complexity, the types of engagements that you are doing as a firm, you need to approach this in a way that is managing your quality risks.

As the IAASB put out their standards, the AICPA went and looked at those standards, as well, and said, "Okay, we need our own project to try and modernize our approach," and they used, as a starting point, what the International [Standard on] Quality Management project did to put together their standards. The PCAOB standard is also, then, going to use those two sets of standards to try and find and figure out, "Based on our environment, based on our mission, where do we want to pull in some of these concepts that existed in these other two realms?"

**Ms. Grove Casey**

Another project that I have heard a lot about in recent years is related to confirmations. So, let's talk a little bit about what the overall objective of that project is.

**Ms. Louis**

Well, the objective of this is to look at the confirmation process itself, particularly thinking about how it needs to be revised to reflect technological changes but, also, how to align the requirements to be better in alignment with the PCAOB's risk-based approach to audits. So, what will happen is to look at, as you design and perform and evaluate the results of confirmation procedures, the standard that exists now has not changed since 1992 when it was first created. We all know that there have been technological advances since 1992. We think about the means in which auditors will now send and receive confirmations including, sometimes, when there are intermediaries involved, where there may be an organization who exists to help facilitate the confirmation process, say, between the auditors and financial institutions.

Auditors, as well, are just using more technology-based tools to perform procedures in general, including alternate procedures when I'm not directly confirming. Is there a way I can use technology to still get pretty persuasive evidence? I can directly access data and information that might be out there in electronic form versus, at the time, in 1992, it is presuming that you were physically mailing documents back and forth to each other.

**Ms. Grove Casey**

The AICPA has recently spent a lot of focus on obligations of various parties related to noncompliance with laws and regulation. Has the PCAOB also been researching the same issue?

**Ms. Louis**

They have, and their original standard back from 1992 dealt with illegal acts by clients. There is movement away from talking about illegal acts—which have to be determined by a judge, a jury, a regulation, a law—to really just focus on noncompliance. What are our obligations as they relate to known or suspected noncompliance with laws and regulations versus us determining that something is an actual illegal act? We may not have the capacity to really make that determination as we are not lawyers; that is not where our area of [expertise] lies.

As we look at what really should be responsibilities, though, it does take into account considering also what has happened with organizations with their ethics and compliance-type programs, things that have evolved since the Sarbanes-Oxley Act was created in 2002 as it relates to internal controls over financial reporting and whistleblowing programs.

So, while there is an AICPA project, they are really focused on nonpublic entities, where the PCAOB perspective will think about noncompliance. They will know that there are certain things, that there are expectations to comply with because we have these SEC requirements—the Sarbanes-Oxley requirements—that are inherently going to be a part of what these SEC filers [and] registered companies need to do as they are following those particular regulations.

**Ms. Grove Casey**

Going concern is a hot topic lately with the uncertainty in the economy. Has the PCAOB pursued a project related to that topic, given the high interest of the general public in terms of disclosure—in particular, fair disclosure?

**Ms. Louis**

There is, and the FASB went and changed GAAP to clarify and enhance the types, and when to have these going concern discussions in their footnotes and what should be included in those footnotes. What we need to do now is to go back and revisit, based on stakeholder needs and based on changes in the auditing

environment, how should there be more clarified guidance to what the auditor's responsibility is? And understanding that that is an important part of an audit, particularly as we are dealing with auditing entities that have to comply with federal securities laws and all these SEC requirements.

The change in FASB GAAP was a step in the process, but now we need to think about what changes need to happen as far as the guidance for the auditors, because the guidance for the auditors also has not changed since it was originally formed back in 1992.

**Ms. Grove Casey**

What other topics is the PCAOB currently pursuing as a formal part of its standard-setting agenda?

**Ms. Louis**

They are looking at some things like substantive analytical procedures and how to better align the requirements for doing these analytics to gather audit evidence, to have it consistent with the auditor's risk assessment, and to understand that the strength of your analytic needs to vary based on the risk that you are trying to deal with in the audit process. In addition, they are having to address how technology that is available to auditors can be used to perform these analytic procedures as you look at various technologies that are out there with spreadsheets and data extraction and other things that could be used to perform and present results that the auditors may rely on in forming their conclusions.

Another project that they are having on the horizon is to think about, as well, fraud and how to better think about the auditor's responsibilities for addressing when there is an intentional act that results in material misstatement in the financial statements and, also, how they can better use technology to try and look for where there may be more fraud risk in a given population. So, both of those are really there, principally, because there is this technological component that is looking at how we can better improve the quality of what we are doing in those specific areas.

**Ms. Grove Casey**

It seems that the use of technology on audits has been an area of frequent discussion lately. In particular, of course, data analytics, and the AICPA is obviously adding that to the exam. Does the PCAOB have anything of that sort related to the technology use in audits on its radar?

**Ms. Louis**

Yes, it is one thing to say, “I’m going to look at a specific area like fraud or analytics and how have technological advances affected what needs to be in that area,” but, in general, they do have a larger project that is looking at, how do we design and perform audit procedures in general that involve technology-assisted data analysis, and focus on a broader-based perspective related to gathering sufficient and appropriate audit evidence as a broad-based thing? How is it that we identify and assess risk and how do we respond to that risk?

This data and technology research project will just focus on the expanded use of technology-based tools from a big-picture point of view, and how it goes into looking at additional guidance, or other things that need to evolve and change, as that role of innovative technology that is out there is having an effect on the quality of audits. This may end up resulting in some new, additional standard-setting projects. It may end up further affecting the scope and nature of other projects that are on the standard-setting agenda, but they do have an eye on that broader-based issue that is out there.

**Ms. Grove Casey**

The original PCAOB audit and attest standards were created back in 2003. They were based on preexisting AICPA standards. Has that caused any issues now that we are a couple decades out from that initial standpoint?

**Ms. Louis**

We are. At this point, seems weird calling them interim standards when, yes, they were created so long ago. Are they really interim anymore? They have, in general, over the course of this time, they have amended, they have replaced, they have eliminated certain standards, but they have never really gone and just looked at the whole complete set of standards and made a specific analysis about, what do we need to retain, maybe in their entirety? What can be retained with minimal updates? What requires more significant changes? Because it is time to not be in an interim-standard perspective. We need to ultimately have just, “Here is what the standards are.”

So, they are looking to make that determination around, how do we update and finalize these standards for their use in fulfilling the mandate of the PCAOB? And that

ultimately, through that process, though, there may be some further improvements related to risk-based audits, or doing integrated audits, or how it is that we can align our standards with how firms are actually using their audit methodologies, and other factors, as well. It is not just the audit standards; there are also interim independence and ethics rules, and interim attest standards for other types of engagements that also are sitting out there for this period of time since 1992.

**Ms. Grove Casey**

Is there any particular area of the interim standards that the PCAOB is prioritizing for that initial review?

**Ms. Louis**

They are looking at what it means to say, “I’m presenting fairly, in conformity with generally accepted accounting principles.” So, that aspect of things in this section that is called the 1000 series of the audit standards, that deals with things like due professional care and independence. So these, as the grounding, the framework that all other standards are built from, they are considering in their view that these are the ones that we should probably start with in determining what needs to change, what does not need to change, and to what degree.

**Ms. Grove Casey**

What about interim attestation standards? What seems to be the biggest initial concerns about those in terms of needing an update?

**Ms. Louis**

Well, it is interesting in that they have the standards to do examinations and agreed-upon procedures. And one of the things is to say, “Well, how much are we actually using them?” As we think about PCAOB standards, when is it that those are actually going to apply? And what types of subject matters are these engagements being done on? To get a sense of the population of how they are being used can actually form a point of view about, then, what needs to change.

**Ms. Grove Casey**

Could you talk a little bit about some specific attestation engagements that may be impacted?



**Ms. Louis**

Well, there are some engagements that might be done. For example, as we think about examinations, it can be examinations around compliance with something. It could be that we are doing something related to Management's Discussion and Analysis. It could be that there is something done with looking at a financial forecast or a projection that could be an examination, or an agreed-upon procedures engagement related to these prospective financial statements. There are a variety of circumstances where these standards seem as if they are useful and are needed. The different subject matters can vary but, currently, what they are doing is trying to determine, what is it that, ultimately, is the most common way in which these items are using the PCAOB rules and regulations in doing this work?

**Ms. Grove Casey**

Would the ethics and independence standards also have to be reviewed for continued propriety since inception?

**Ms. Louis**

Obviously, that also should occur and should look to see, as we think about the obligations that might need to be enhanced or updated, to better promote compliance with things like independence and ethical-type behaviors.

### PCAOB Auditing Standards—Recent Activity

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by Jennifer F. Louis, CPA

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#### Background

The mission of the Public Company Accounting Oversight Board (PCAOB) is to oversee the audits of public companies and Securities and Exchange Commission (SEC)-registered brokers and dealers in order to protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports. To most efficiently and effectively advance its mission, it devoted efforts on executing against a five-year strategic plan.

Effective oversight is implemented through the following means:

1. Inspections—Presenting useful information meant to improve audit quality and quality control systems.
2. Enforcement—Prioritized based on what is likely to have the greatest benefit for investors.
3. Standard-setting—Focused on issues considered to be most important to the PCAOB mission.

#### Requirements for Lead Auditor's Use of Other Auditors

The roles of other auditors have increased as companies' global operations have grown.

The objective of this auditing standards change is to strengthen requirements that apply to audits involving multiple audit firms. The amendments are designed to improve the quality of audits in these circumstances by increasing the lead auditor's involvement in and evaluation of the work of other auditors, and to align the applicable requirements with the PCAOB's risk-based supervisory standards.

In these audits, the "lead auditor" issues the audit report on the company's consolidated financial statements, but "other auditors" often perform important work on the audit. In addition, a new auditing standard will apply when the lead auditor divides responsibility for an audit with another accounting firm ("referred-to auditor").

Working with other auditors and referred-to auditors can differ from working with people in the same firm, creating challenges in coordination and communication. These challenges can lead to misunderstandings about the nature, timing, and extent of their work and can reduce audit quality. It is important for investor protection that the lead auditor adequately plan and supervise the work of other auditors so that the audit is performed in accordance with PCAOB standards and provides sufficient appropriate evidence to support the lead auditor's opinion in the audit report.

This rulemaking is intended to increase and improve the lead auditor's involvement in, and evaluation of, the other auditors' work. The heightened attention to other auditors' work will improve communication among auditors and the lead auditor's ability to prevent or detect deficiencies in that work and, thus, enhance the quality of audits involving other auditors and promote investor protection.

The amendments to the Board's auditing standards are intended to improve PCAOB standards principally by:

- Applying a risk-based supervisory approach to the lead auditor's oversight of other auditors, and
- Requiring that the lead auditor perform certain procedures when planning and supervising an audit that involves other auditors.

The amendments consider recent practice developments in the lead auditor's oversight of other auditors' work, including greater use of communication technology. In brief, the amendments:

1. Require that the engagement partner determine whether his or her firm's participation in the audit is sufficient for the firm to carry out the responsibilities of a lead auditor and report as such. The amendments also provide considerations for the engagement partner to use in making this determination and require that the audit's engagement quality reviewer review the determination.

2. Require that the lead auditor, when determining the engagement's compliance with independence and ethics requirements, understand the other auditors' knowledge of those requirements and experience in applying them. The amendments also require that the lead auditor obtain and review written affirmations regarding the other auditors' policies and procedures related to those requirements, compliance with the requirements, and a description of certain auditor-client relationships related to independence. In addition, the amendments require the sharing of information about changes in circumstances and the updating of affirmations and descriptions in light of those changes.
3. Require that the lead auditor understand the knowledge, skill, and ability of other auditors' engagement team members who assist the lead auditor with planning and supervision, and obtain a written affirmation from other auditors that their engagement team members possess the knowledge, skill, and ability to perform assigned tasks.
4. Require that the lead auditor supervise other auditors under the Board's standard on audit supervision and inform other auditors about the scope of their work, identified risks of material misstatement, and certain other key matters. The amendments also require that the lead auditor and other auditors communicate about the audit procedures to be performed, and any changes needed to the procedures. In addition, the amendments require the lead auditor to obtain and review written affirmations from other auditors about their performance of work in accordance with the lead auditor's instructions, and to direct other auditors to provide certain documentation about their work.
5. Provide that, in multi-tiered audits, a first other auditor may assist the lead auditor in performing certain required procedures with respect to second other auditors.

This rulemaking rescinds an interim standard; however, it carries forward and strengthens some of its requirements in a new standard that applies to those infrequent situations where the lead auditor divides responsibility for a portion of the audit with another audit firm and, therefore, does not supervise the work performed by that firm. In these situations, the lead

auditor refers in the audit report to the work of that auditor (i.e., a referred-to auditor). This new standard requires that, in these situations, the lead auditor determine that audit procedures were performed regarding the consolidation or combination of financial statements of the business units audited by the referred-to auditor into the company's financial statements.

The standard also requires that the lead auditor obtain the referred-to auditor's written representation that it is independent and duly licensed to practice, and that the lead auditor disclose in the audit report the magnitude of the portion of the financial statements and, if applicable, internal controls audited by the referred-to auditor.

### **Standard-Setting and Research Agendas**

The standard-setting and research agendas are intended to further the Board's objective of advancing audit quality in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

The PCAOB's approach to advancing audit quality through standards, interpretations, and other guidance prioritizes select standard-setting projects. Specifically, through the standard-setting agenda, the PCAOB expects to strengthen auditing, quality control, and other professional practice standards in a number of targeted areas: audit firm use and oversight of other auditors, audit firm quality control systems, and audit firm transparency (for example, reporting on a company's ability to continue as a going concern).

In addition, the standard-setting agenda also represents the PCAOB's priority of strengthening requirements for the audit of financial statements and modernizing and streamlining existing interim standards to reflect the impact of technological changes to financial reporting and audit practice, as well as the audit profession's evolution over time. In many instances, projects are included in the agendas, in part, because they address more than one of these priorities.

Alongside these standard-setting projects, the PCAOB also is actively researching certain topics that will inform the standard-setting agenda and will enable it to respond quickly to changes in the audit environment, including changes resulting from advances in the use of data and technology in the preparation and audit of financial statements.

The agendas are the result of the new Board's assessment of priorities that advance audit quality to protect the interest of investors. The agendas will provide transparency by informing all stakeholders about projects that are actively being developed by PCAOB staff and the anticipated timeline of the completion of each such project. Going forward, the agendas will be dynamic and will change in response to developments from PCAOB oversight activities; engagement with investors and other stakeholders, including through PCAOB advisory groups; discussion with U.S. SEC staff; observations of the work of other standard-setting bodies; and other relevant inputs.

### ***Quality Control***

The objective is to consider how PCAOB quality control (QC) standards should be revised to enhance and strengthen requirements related to a firm's QC system. Effective QC systems are crucial for consistent high-quality audits and other engagements under PCAOB standards. PCAOB QC standards require a firm to design and implement a quality control system that provides reasonable assurance that the firm's personnel comply with applicable professional standards and with the firm's standards of quality.

Registered firms are required to design and implement a system of quality control to provide this reasonable assurance.

The project has taken into account developments since PCAOB QC standards were first adopted, including evolving developments in audit practices and in use of technology, and improvements in monitoring and remediation processes.

The International Auditing and Assurance Standards Board (IAASB) has recently issued new and revised standards to strengthen and modernize an audit firm's approach to quality management. The standards are effective December 15, 2022.

Through the standards, the IAASB is addressing an evolving and increasingly complex audit ecosystem, including growing stakeholder expectations and a need for quality management systems that are proactive and adaptable. The standards direct audit firms to improve the robustness of their monitoring and remediation, embed quality into their corporate culture and the "tone at the top," and improve the robustness of engagement quality reviews.

Many firms that follow PCAOB standards are also subject to other QC standards, including the IAASB and the American Institute of Certified Public Accountants (AICPA) standards; thus, they are required to implement QC systems that comply with both PCAOB standards and those other standards.

The PCAOB project is considering the results of the recent IAASB project, a recent AICPA project, and other revisions that would result in a future PCAOB QC standard that is scalable, so that a firm can tailor its QC system appropriately, based on the firm's size and complexity and the nature of the engagements it performs, commensurate with applicable risks to quality.

### ***Confirmations***

The objective of this project is to consider changes to the confirmation process, including how Auditing Standard (AS) 2310, *The Confirmation Process*, should be revised to reflect changes in technology, as well as to align more closely with the PCAOB's risk assessment standards.

AS 2310 establishes requirements for the use of confirmations in an audit, including requirements for designing, performing, and evaluating the results of confirmation procedures. While the standard has remained largely unchanged since its issuance in 1992, the following developments have taken place:

- **Changes in technology:** Auditors are now utilizing various methods to send and receive confirmations, including the use of intermediaries. Additionally, many auditors are expanding their use of technology-based tools to perform alternative procedures; and
- **Adoption of the Board's risk assessment standards:** AS 2310 predates the adoption of the Board's risk assessment standards and, therefore, does not expressly prompt auditors to consider the risks of material misstatement when designing confirmation requests, including risks of material misstatement related to fraud.

### ***Noncompliance with Laws and Regulations***

The objective is to consider changes to an auditor's consideration of possible noncompliance with laws and regulations, including how AS 2405, *Illegal Acts by*

*Clients*, should be revised to integrate a scalable, risk-based approach that takes into account recent developments in corporate governance and internal control practices.

AS 2405 establishes requirements regarding the auditor's consideration of a company's possible illegal acts in an audit of financial statements. While the standard has remained largely unchanged since its issuance in 1988, the following developments have taken place:

- Adoption of the Board's Risk Assessment Standards: AS 2405 predates the adoption of the Board's risk assessment standards and, therefore, might need to be modified;
- Companies' Ethics and Compliance Programs: There have been significant changes affecting companies' approaches to complying with applicable laws and regulations, as well as investor expectations; and
- ICFR and Whistleblower Programs: There have also been important statutory developments. As part of the Sarbanes-Oxley Act of 2002, in addition to requiring certain companies and their external auditors to report on the adequacy of the internal control over financial reporting, Congress also requires public company audit committees to establish whistleblower programs for submission of anonymous tips and complaints related to accounting, auditing, and internal control matters.

### **Going Concern**

The objective of this project is to consider the auditor's evaluation and reporting of a company's ability to continue as a going concern in response to changes in financial reporting, the auditing environment, and stakeholder needs, including consideration of how AS 2415, *Consideration of an Entity's Ability to Continue as a Going Concern*, should be revised.

The auditor's evaluation of a company's ability to continue as a going concern is an important part of an audit under both PCAOB standards and federal securities law.

Changes to applicable financial reporting frameworks have established requirements for management to evaluate and disclose, in the financial statements,

management's own assessment of the company's ability to continue as a going concern. These changes, and concerns from investors about the effectiveness of auditor going-concern reporting, have prompted questions about the need for changes to AS 2415.

### **Substantive Analytical Procedures**

This project will consider changes to an auditor's use of substantive analytical procedures to better align with the auditor's risk assessment and to address the increasing use of technology tools in performing these procedures, including whether to revise AS 2305, *Substantive Analytical Procedures*.

### **Fraud**

This project will consider how AS 2401, *Consideration of Fraud in a Financial Statement Audit*, should be revised to better align an auditor's responsibilities for addressing intentional acts that result in material misstatements in financial statements with the auditor's risk assessment, including addressing matters that may arise from developments in the use of technology.

### **Amendments Related to Certain Aspects of Designing and Performing Audit Procedures that Involve Technology-Assisted Data Analysis**

The objective of this project is to consider how PCAOB standards should be revised to address certain aspects of designing and performing audit procedures using technology-assisted data analysis.

The results of the PCAOB's research project on Data and Technology indicate that auditors are expanding their use of technology-based tools to plan and perform audits. While the research results indicate that PCAOB standards do not preclude auditors' use of technology, it may be necessary to update the following auditing standards to address certain aspects of designing and performing audit procedures that use technology-assisted data analysis:

- AS 1105, *Audit Evidence*
- AS 2110, *Identifying and Assessing Risks of Material Misstatement*
- AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*

### **Data and Technology-Research Project**

The objective of the Data and Technology research project is to assess whether there is a need for guidance, changes to PCAOB standards, or other regulatory actions in light of the increased use of technology-based tools by auditors and preparers. This includes evaluating the role technology innovation plays in driving audit quality. Research from this project may give rise to individual standard-setting projects and may also inform the scope or nature of other projects that are included on the standard-setting agenda.

Advancements in technology are affecting the nature, timing, preparation, and use of financial information. Auditors are expanding their use of technology-based tools, including data analytics, to plan and perform audits. The increased use of these technology-based tools could affect areas such as:

- The auditor’s risk assessment and response to identified risks of material misstatement;
- The nature and extent of information available to auditors and preparers; and
- Audit firms’ quality control systems.

### **Interim Standards—Overall**

The objective of this project is to consider whether the remaining “interim” standards, as adopted upon the establishment of the Board, should be amended, replaced, or eliminated, as appropriate. As part of this analysis, evaluate which standards are necessary to retain and, of those, which should be retained with minimal updates and which require more significant changes. Separate projects, including requests for comment on potential standards to eliminate, will be added to the standard-setting agenda as the staff completes its analysis.

In April 2003, the Board adopted, on an interim basis, certain standards of the AICPA (collectively, the “interim standards”). A number of these standards have since been updated or replaced through the Board’s standard-setting initiatives. The remaining interim standards, however, continue to be in effect substantially in the form adopted. The Board has instructed the staff to evaluate the remaining interim standards to determine whether these standards remain fit for use in fulfilling its mandate of investor protection.

Since adoption of the interim standards, the auditing environment has evolved, including changes resulting from:

- Improvements to risk assessment, documentation, and reporting requirements through Board-issued standards;
- Implementation of audit requirements for integrated audits;
- Advancements in technologies relevant to financial reporting;
- Activities of other standard-setters and regulators; and
- Alignment of firm methodologies with a risk-based approach.

The remaining interim standards are comprised of:

- Auditing standards, including certain standards related to general responsibilities of the auditor, audit procedures for specific accounts or aspects of the audit, concluding audit procedures, and special topics;
- Attestation standards, including those related to general attest engagements, agreed-upon procedures, and compliance attestation; and
- Ethics and independence standards.

While the concepts in many of the remaining interim standards remain sound, some of these standards may be in need of relatively minor updates and others may be in need of more extensive changes. In addition, some of these interim standards may no longer be necessary to retain (for example, if there is no application for the standard in current practice or if concepts in the standard could be incorporated into another standard for a more logical presentation).

### **Interim Standards—AS 1000**

The objective of this project is to consider changes to auditing standards in the AS 1000 series and in AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles.”*

The auditing standards included in this group of standards are:

- AS 1001, *Responsibilities and Functions of the Independent Auditor*;
- AS 1005, *Independence*;
- AS 1010, *Training and Proficiency of the Independent Auditor*;
- AS 1015, *Due Professional Care in the Performance of Work*; and
- AS 2815, *The Meaning of “Present Fairly in Conformity with Generally Accepted Accounting Principles.”*

These standards continue to be in effect substantially in the form adopted by the Board on an interim basis from the AICPA in April 2003. In the staff’s view, the concepts in these standards (e.g., due professional care and professional skepticism) remain sound, but the standards could be modernized and streamlined through updates that would clarify auditor responsibilities and enhance the usability of the standards by making them easier to read, understand, and apply. In addition, the requirements in the standards could be aligned, where necessary, with other PCAOB standards and PCAOB rules.

### ***Interim Attestation Standards Update***

The staff of the Public Company Accounting Oversight Board is requesting information and public comment on matters related to the application and use of the Board’s interim attestation standards.

In April 2003, the Board adopted on an “interim basis” certain attestation standards from the AICPA. These standards have continued in effect substantially as they were adopted. The Board is committed to modernizing its standards, and this document requests information and comment from the public to inform any staff recommendation to the Board regarding updates to the interim attestation standards, including possible consolidation or elimination of certain standards.

Registered public accounting firms are sometimes engaged to examine and report on matters outside of an audit of financial statements. These engagements include examination, review, and agreed-upon

procedures engagements, which involve issuing a report on subject matter, or an assertion about subject matter, that is the responsibility of another party (“attest engagements”). The subject matter of an attest engagement can vary and may relate to, for example, a company’s compliance with laws and regulations, or a company’s historical data or measures that are evaluated against certain criteria.

An attest engagement performed under PCAOB standards is designed to provide a certain level of assurance (as described below) and involves issuing a corresponding report (“attestation report”):

- Examination attest engagements provide reasonable assurance;
- Review attest engagements provide moderate assurance; and
- Agreed-upon procedures attest engagements do not provide specific assurance but involve a report on the performance of specified procedures and the resulting findings.

PCAOB attestation standards consist of one foundational standard (AT 101) and five topic-specific standards:

1. AT 101, Attest Engagements. AT 101 establishes a framework applicable to examination, review, and agreed-upon procedures attest engagements on subject matter or an assertion about subject matter. AT 9101, Attest Engagements: Interpretations of Section 101, provides guidance on the application of AT 101 in certain circumstances.
2. AT 201, Agreed-Upon Procedures Engagements. AT 201 addresses performing and reporting on agreed-upon procedures attest engagements.
3. AT 301, Financial Forecasts and Projections. AT 301 addresses examination and agreed-upon procedures attest engagements on prospective financial statements.
4. AT 401, Reporting on Pro Forma Financial Information. AT 401 addresses examination and review attest engagements on pro forma financial information.

5. AT 601, Compliance Attestation. AT 601 addresses examination and agreed-upon procedures attest engagements related to (a) an entity's compliance with requirements of specified laws, regulations, rules, contracts, or grants; or (b) the effectiveness of an entity's internal control over compliance with specified requirements.
6. AT 701, Management's Discussion and Analysis. AT 701 addresses examination and review attest engagements with respect to management's discussion and analysis prepared pursuant to U.S. SEC rules and included in an annual report or other document.

Attestation reports may relate to various subject matter and provide different levels of assurance based on the type of attest engagement performed. The staff is interested in how attestation reports are used and what role they play in informing and protecting investors.

Currently, attest engagements are often being performed under AT 101, AT 201, and AT 601, and the staff understands that such engagements primarily involve examination and agreed-upon procedures reports. Many of these engagements are compliance attest engagements and relate to, for example:

- (i) Examinations of securities and similar investments held by an investment company subject to the requirements of Rule 17f-2 under the Investment Company Act of 1940, or
- (ii) For asset-backed security issuers, the assessment of compliance with the servicing criteria of SEC Regulation AB.

As another example, some firms issue agreed-upon procedures reports pursuant to Securities Investor Protection Corporation (SIPC) requirements, in connection with broker-dealer contribution calculations.

By contrast, attest engagements are generally not being performed related to financial forecasts and projections, pro forma financial information, or management's discussion and analysis (conducted under AT 301, AT 401, or AT 701) in recent years. The PCAOB staff is seeking additional information about whether, and how, the PCAOB attestation standards are used, including current and emerging circumstances that give rise to such engagements.

### ***Interim Ethics and Independence Standards***

In connection with the PCAOB's Interim Standards Project, this project will consider whether PCAOB-registered firms' and their associated persons' existing obligations should be enhanced and updated to better promote compliance through improved ethical behavior and independence.





## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Discuss how the recent change to the PCAOB Auditing Standards related to a “Lead Auditor’s Use of Other Auditors” will improve the quality of audits.
2. What does the PCAOB intend to achieve through its standard-setting and research agendas?
3. Discuss the PCAOB’s consideration of “interim” standards and the objective of this project.

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## B. Suggested Answers to Discussion Problems

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1. The amendments to the Board's auditing standards are intended to improve PCAOB standards principally by:

- Applying a risk-based supervisory approach to the lead auditor's oversight of other auditors, and
- Requiring that the lead auditor perform certain procedures when planning and supervising an audit that involves other auditors.

The amendments consider recent practice developments in the lead auditor's oversight of other auditors' work, including greater use of communication technology. In brief, the amendments:

- a. Require that the engagement partner determine whether his or her firm's participation in the audit is sufficient for the firm to carry out the responsibilities of a lead auditor and report as such. The amendments also provide considerations for the engagement partner to use in making this determination and require that the audit's engagement quality reviewer review the determination.
- b. Require that the lead auditor, when determining the engagement's compliance with independence and ethics requirements, understand the other auditors' knowledge of those requirements and experience in applying them. The amendments also require that the lead auditor obtain and review written affirmations regarding the other auditors' policies and procedures related to those requirements, compliance with the requirements, and a description of certain auditor-client relationships related to independence. In addition, the amendments require the sharing of information about changes in circumstances and the updating of affirmations and descriptions in light of those changes.
- c. Require that the lead auditor understand the knowledge, skill, and ability of other auditors' engagement team members who assist the lead

auditor with planning and supervision, and obtain a written affirmation from other auditors that their engagement team members possess the knowledge, skill, and ability to perform assigned tasks.

- d. Require that the lead auditor supervise other auditors under the Board's standard on audit supervision and inform other auditors about the scope of their work, identified risks of material misstatement, and certain other key matters. The amendments also require that the lead auditor and other auditors communicate about the audit procedures to be performed, and any changes needed to the procedures. In addition, the amendments require the lead auditor to obtain and review written affirmations from other auditors about their performance of work in accordance with the lead auditor's instructions, and to direct other auditors to provide certain documentation about their work.
  - e. Provide that, in multi-tiered audits, a first other auditor may assist the lead auditor in performing certain required procedures with respect to second other auditors.
2. The PCAOB's standard-setting and research agendas are intended to further the Board's objective of advancing audit quality in order to protect the interests of investors and further the public interest in the preparation of informative, accurate, and independent audit reports.

The PCAOB's approach to advancing audit quality through standards, interpretations, and other guidance prioritizes select standard-setting projects. Specifically, through the standard-setting agenda, the PCAOB expects to strengthen auditing, quality control, and other professional practice standards in a number of targeted areas: audit firm use and oversight of other auditors, audit firm quality control systems, and audit firm transparency (for example, reporting on a company's ability to continue as a going concern).

In addition, the standard-setting agenda also represents the PCAOB's priority of strengthening requirements for the audit of financial statements

and modernizing and streamlining existing interim standards to reflect the impact of technological changes to financial reporting and audit practice, as well as the audit profession's evolution over time. In many instances, projects are included in the agendas, in part, because they address more than one of these priorities.

3. The objective of this project is to consider whether the remaining "interim" standards, as adopted upon the establishment of the Board, should be amended, replaced, or eliminated, as appropriate. As part of this analysis, evaluate which standards are necessary to retain and, of those, which should be retained with minimal updates and which require more significant changes. Separate projects, including requests for comment on potential standards to eliminate, will be added to the standard-setting agenda as the staff completes its analysis.

In April 2003, the Board adopted, on an interim basis, certain standards of the AICPA (collectively, the "interim standards"). A number of these standards have since been updated or replaced through the Board's standard-setting initiatives. The remaining interim standards, however, continue to be in effect substantially in the form adopted. The Board has instructed the staff to evaluate the remaining interim standards to determine whether these standards remain fit for use in fulfilling its mandate of investor protection.



## PART 3. SMALL BUSINESS

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### Efficiencies in Review Engagements

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Review engagements are limited assurance engagements and primarily use inquiry and analytics to determine if the financial statements are materially correct in accordance with the applicable financial reporting framework chosen. While a substantial amount of judgment is permitted under the SSARS, some firms perform far more than the minimum requirements and may be inefficient when completing their engagements.

For more on efficiencies in review engagements, let's join Kurt Oestrieher, CPA and a partner with Oestrieher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

#### Ms. Grove Casey

Today we want to talk a little bit about efficiencies in review engagements because really that's a limited assurance engagement. If we overperform our procedures, then we're maybe stretching our way towards an audit, and it doesn't actually become cost effective for us to be doing a review. So, to begin with, let's talk a little bit about where does the review fit in the world of the AICPA standards.

#### Mr. Oestrieher

I think most people understand that it's in between an audit and a compilation. The question really is, "Where is it?" Is it exactly halfway between [them], or is it closer to a compilation? Or is it closer to an audit? Because we use that as a judge of how much work should we do? Quite frankly, that isn't really where we need to look. We need to look at what the standards tell us to do, and we will get into that. But again, this is Kurt's opinion. Am I supposed to say, "And by the way, the opinions of the presenter are not necessarily the opinions of anybody that owns this company?" But I think y'all hire me for my opinions.

Now, my opinion on this is geared because of who are the standards setters? When you look at audit, review, and compilation, the audit standards are written by the Auditing Standards Board. The compilation and review standards are written by the Accounting and Review Services Committee, the SSARS. So, not only is the review—it's kind of a distant cousin of the Auditing Standards Board. It lives in the same house as the compilation. They're like brothers and sisters, where over there are my cousins that I only see on Thanksgiving or Christmas, or funerals and weddings and things like that. From that perspective, when you look at the history of it and you go back to SSARS No. 1, AR-C §100 used to

have guidance on both compilations and reviews. So, not only were they written by the same committee, they were in the exact same section. There'd be a couple of paragraphs on a compilation and say, "Oh, and by the way, if you're doing a review, add this." So, understand that's where it started. From my perspective, it's always been, hey, a review is closer to a compilation.

But—and this is a big but—the AICPA has deliberately and conscientiously started to try to change that because, from the AICPA's perspective, an audit and a review provide assurance. Those are assurance services, and the compilation and preparation engagements are not assurance services. So, the AICPA is doing things to move that review. Even though the standards are written by the Accounting and Review Services Committee, [the AICPA is] conscientiously making decisions so that the perception and the appearance of the review looks more like an audit.

And to that end—this is something I've thought about out loud, and I have yet to meet a peer that thinks it's a bad idea—but if I were asked by—and trust me, I will never be asked to do this—but if I were asked by the AICPA to come in and be a consultant and talk about how the whole standard-setting process is arranged, one of the things that I would recommend, I said, "Well, wait a second. Think about this logically. You've got four sets of services: audit, review, compilation, and preparation. Two of those are assurance services, and two of them are non-assurance services. Yet you have one committee that's addressing three of those sets of standards. That's the ARSC, Accounting and Review Services Committee; they are addressing standards for both assurance and non-assurance. And we have the Auditing Standards Board, which is addressing just the audits. Why don't you split it up? Make it two and two and have the Auditing Standards Board update the review standards. In other words, pull those out of

comp and review, pull them out from the ARSC, and let the Auditing Standards Board handle those standards because assurance is provided. Then let the Accounting and Review Services Committee handle the preparation and compilation.” Quite frankly, that makes so much sense to me, I don’t know why they haven’t done that already.

Now, the fear for that, and maybe one reason why I wouldn’t want that to happen—you know, a kind of on-the-other-hand-type deal—is, I like where the review standards are right now as far as what we have to do. I mean, we’re going to get into—what are the primary procedures? So it is more the appearance standpoint.

Case in point: many of us that performed compilations—remember, it wasn’t that long ago—we had to have a title in the compilation report. It had to say “Independent Accountant’s Compilation Report” or “Accountant’s Compilation Report.” We had an addressee, and then we had paragraph headings. So, the compilation, the review, and the audit report all had that same look and feel. Well, the AICPA’s entire brain trust over the vice president in charge of accounting and auditing standards said, “No, because one’s assurance and one’s not, we’re going to continue to have that format, if you will, for the review report with the paragraph headings, with the title.” But on the compilation, they took away the report heading. They took away the paragraph heading. They even took away the address. It just starts out, “Management is responsible for.” So, those are the types of look-and-feel things that we’re seeing from the AICPA.

We have seen where now they require you to calculate materiality in a review. We never had to do that until SSARS No. 25, which became effective for your December 31, 2021, reviews. But I don’t want to see too many more. I mean, the day that they make us obtain an understanding of internal control in the review, I’m going to slap somebody, Debi. I don’t like to be a violent person, but, I think, unfortunately those might be the baby steps. But no, we don’t—trust me, unless we change the objective of a review, there will never be a reason for us to obtain an understanding of internal control in them.

That’s my fear. So that’s why I—if I was a consultant, maybe we’d have the auditing standards board, we’d have the review standards board, and then maybe create a whole new committee or a new board that just handles reviews. So, it is a very interesting dynamic that we’re

seeing, and I think we are going to continue to see some changes in the future. The standard setting process never starts at all, but eventually, something’s got to give. It just doesn’t make sense the way it is now. So, it’s going to be something varying. I may be retired by the time they change it, but changes are eventually going to come, I think there.

### Ms. Grove Casey

Let’s talk about limited assurance, because that’s what reviews provide. They provide limited assurance where an audit provides reasonable assurance. And then we have the no-assurance services.

### Mr. Oestrieher

If you ever say—oh, what’s the word—*negative assurance*. Don’t ever use that term around anyone at the AICPA that’s ever been associated, because it’s not negative assurance. If you read the report, we never say negative assurance. It’s *limited assurance*. Let’s just look at the English language, and it is what it sounds like. It is a level of assurance that is lower than the reasonable assurance that we’re given in the audit, yet it is some level of assurance. You won’t find that exact definition, but that’s what it means—less than, very limited.

When you look at both the engagement letter and the report—we inform management in the engagement letter [and] we inform users in the report that limited assurance is substantially less in scope than the audit. The types of things that we’re going to do to obtain limited assurance are substantially less in scope. The word *substantial* to me means “a lot.” It means this is not a mini audit. There are gigantic differences. There are gigantic expectations as to what the user should believe that the accountant did in order to go find the GAAP departure.

[They go] further on to say that, to obtain this limited assurance, we will primarily perform inquiry and analytical procedures. That’s both in the engagement letter and the report. So, if you look at the report, it even goes on to say, “Therefore, we do not contemplate performing audit procedures such as confirmation, inspection, [or] recalculation.” There’s that much detail that is provided to the user, so that is what limited assurance is.

We, as practitioners, need to understand that if we are going above and beyond what is defined as limited assurance and then communicated in both an

engagement letter and an report—as you pointed out, Debi—not only does it get closer to an audit—sometimes you say, well, did you address the appropriate report—but now you are increasing your standard of care. Unfortunately, I've done just enough work in lawsuits, whether it's pretrial review panel or serving as expert witness, to understand what *standard of care* means. There's some good things about that. One of the things is, it means that, if you forget to sign off on a workpaper, a jury shouldn't find you negligent, and you know that there's causation in all this. But standard of care can be established by not only what the minimum standards are, but how you are performing in your engagement.

So, I've always used this as an example. We're talking about a lot of efficiencies later on, but just for this example, I get a copy of the bank rec. I tie the bank rec and look at unusual reconciling items on receivables. I look at subsequent collections. In other words, all these things that we tell people we're not going to do because they're usually in an audit and we're not comfortable. Well, we do them anyway for no particular reason other than maybe to keep our staff busy. But then we get into inventory. We don't do any of those types of procedures for inventory. However, inventory, a lot of times, that's going to be the single biggest component of your current assets. And it relates directly to cost of sales, which is typically the single biggest expense item. And, let's say, later on there [were] in fact, issues related to inventory and cost of sales, and your inquiry and analytical procedures didn't find that departure. Well, normally you would be fine there, but if you internally had said, "Oh, look at all these audit procedures on cash and all the audit procedures on receivables." You've now established a level of inquiry, analytical, and other procedures that there's an expectation that you're going to do that through out the engagement.

So that's a key thing we need to understand with limited assurance. We need to stay with these: inquiry, analytical procedures, [and] rep letter. If we expand beyond that, there has to be a reason, and, typically, there's not going to be a reason to expand beyond that. So, your limited assurance is going be from what? Inquiry, analytical, rep letter. A lot of people go, "Wow, that's not a whole lot. That's all we're doing?" Yes. That's why it's called limited assurance. That's why, to perform a review properly—and I will tell you, we were going way beyond the expectations of standards in our firm years ago, until we just had a realization that, no, we've got to change something here. The hardest thing

for us to accept—and, and once we did, it became very easy—was that it is more likely that a GAAP departure will go undetected in a review than it would in an audit.

You go, "Whoa, wait, Kurt, you don't go to the ends of the earth to find a GAAP departure regardless of the level of service the client has engaged you [for]?" No, I don't. If they go through the drive-through and order a Big Mac, I'm going to give them a Big Mac. We'll call that the audit. But if they come through and want a double cheeseburger and I charge them for a double cheeseburger, I'm not giving them the Big Mac, okay? I can't make money that way. And now I'm overdelivering if you will. So, we have to keep in mind that limited assurance means we're going to perform fewer procedures, and, therefore, GAAP departures that would've been detected in an audit may not be detected. That is so hard for us to accept, but we need to. Otherwise, we need to just do audits then. Don't do the review if you can't accept that limitation of the limited assurance.

#### **Ms. Grove Casey**

So, let's talk a little bit about what a firm can do to increase their efficiency so that they're not overperforming on a review. Right?

#### **Mr. Oestrieher**

Well, one of the first things that we learned--and it's right in the title of the standards—we, Debi, man, we were awesome at reviewing trial balances. Okay? But that's not what it says. You're reviewing financial statements. So, we weren't even really performing inquiries on disclosures. We were looking at relationships of items on the trial balance, which gets us into too much detail. So, my recommendation is to review financial statements. Focus on the financial statements, which means you need to get the financial statements at the earliest point of the engagement. Now, in a perfect world—which, obviously, I don't live in; none of us do—but in a perfect world, our clients give us a set of financial statements to review. That doesn't happen. They give us the trial balance, and then we assist them in preparing the financial statements.

Well, a client that we don't anticipate that we're going to have any adjustments in the review—and we have many of those because they have in-house CPAs that are very intelligent. And, thankfully, they're Sub[chapter] S corporations, so we don't even have to do the tax accrual for them because there is no tax



accrual. Okay? So, we're not expecting any adjustments. Folks, as soon as I get that, the first thing we do is write the financial statements. Okay? Now I am going to be applying inquiry and analytical procedures to elements of the financial statements. I'm going to have the statement of cash flows prepared, so I'm going to perform analytical procedures on the statement of cash flows. I will have completed a disclosure checklist, which maybe includes inquiries. Now I thought of, "Oh, I've got to ask the client about this particular concentration, or this particular risk, or this particular subsequent event." So, reviewing financial statements and getting those done at the earliest possible point has led us to be so much more efficient.

Again, rather than focusing on, "Oh, look at prepaid insurance." Well, I've got seven prepaid expenses. I'm not focusing on prepaid insurance. They're all combined on the balance sheet as one account. That's what I need to be focusing on, so I become more efficient because I'm limiting the actual numbers of data that I am performing those inquiry and analytical procedures on. That was one of the biggest things we did—we write the financial statements at the earliest point possible.

And for people out there that believe that's inefficient because they go, "Well, what if you have to change a number?" In 1984, that would've been a problem because I'd have had to retype the financial statements with the emphasis on the word *type* with the typewriter. I think we had advanced onto carbon paper at that point, but I'm not sure we'd have the six copies. But, folks, now you just make the change on Excel [or] Word. I mean, I can change a set of financial statements in 10 minutes or less. So, the efficiencies that we gain from having the numbers that are appearing on the financial statement far outweigh any risks that we do, in fact, become aware of a GAAP departure and have to change those financial statements.

### **Ms. Grove Casey**

Let's talk a little bit about the situation that you mentioned at the beginning, which is where we get the trial balance, and, a lot of times, we end up having to make adjustments in order to get to the financial statements. And we have a lot of bookkeeping or back-office clients, right? Should we be doing those bookkeeping procedures as part of the review engagement like we typically end up doing with the audit?

### **Mr. Oestrieher**

Actually, you put two great elements in that question. The first one, as far as the clients that we do the back-office accounting for, we have disclosed our undying love and lack of independence for those folks long ago.

### **Ms. Grove Casey**

Right. So, no review.

### **Mr. Oestrieher**

When they need a review, we prepare the financials and send those to another firm. And we have some reviews that are the other way, so that's how we've done that. Now you're right, 20 years ago, you could do all of that—or 25 years ago maybe—but we're talking about what I always like to call my *Aunt Edna clients*. Those are in between the CPA that always gets it right and then those clients [for whom] we do the client accounting services.

Aunt Edna is a dedicated soul who, at one time, called herself a full charge bookkeeper, but I believe that's a pretty old term. We don't hear that much anymore. Aunt Edna can get most everything right, but she needs help with a few things. And I am so good [that] I can spot a GAAP departure with one inquiry of that client when they sign the engagement letter. I say, "Is Aunt Edna still your bookkeeper?" And they say, "Yes." And, by the way, Edna's in the memory of my grandmother, Edna Oestrieher. That's why I call them Aunt Edna. And that means that I know that Aunt Edna's going to have at least four things in "ask my accountant." I also know that all of the note payments to Ford Motor Credit are vehicle expense rather than broken out between principal and interest. I know that depreciation is recorded and a few other things.

If you're listening in here, you have your Aunt Ednas. There's enough there that Aunt Edna has suitable skill, knowledge, and/or experience to oversee the service. But I know there's going to be adjustments, so I don't send a reviewer out first. I send, generally, one of my staff out—maybe it's the person that's going to work on the tax return. They go visit with Aunt Edna, and they reclass everything that's an "ask my accountant." Now, again, make sure you follow the independence rules—that Aunt Edna approves it, that she understands the move, and that she agrees with the move—but reclass everything in "ask my accountant." Reclass the vehicle expense that is miscoded. Heaven forbid if there was a sale of an asset this year; then we know everything's

wrong. That's a debit to cash and a credit to "ask, my accountant," right? So, then we have to go figure out the basis and the gain of the sale for both book and tax purposes, but we don't do that as part of the review. The bookkeeper does that.

When we're finished, we send the client a bill for assistance in closing the books at the end of the year because I want the client to understand. I know you love Aunt Edna, and we love Aunt Edna. But this is how much it costs you by having her rather than a CPA or somebody that could have gotten it that point without our assistance. And, by the way, generally, the salary of Aunt Edna and all the benefits plus what they pay us is less than what it would cost for a CPA. So, everyone's happy. Aunt Edna's still employed, and life moves on. So, the value that we had—because now, when we are performing analytical procedures, the fact that we can write the financial statements and then perform those analytical procedures without departures that are already embedded in there that we know we have to fix, that has just done a tremendous amount to help us become more efficient in our review engagements.

#### **Ms. Grove Casey**

Well, speaking of that, what about limiting the number of team members involved? Because, typically, if you've got a partner involved that immediately jacks the cost up, right? It brings down the—I don't want to say the efficiency of the review because it is important to get it right—but it does not help your bottom line.

#### **Mr. Oestrieher**

Interestingly enough, it all depends on the review. Many of our review engagements, we do have partners performing because [with] the experience of that partner, we're not doing wasted stuff. For a long time, Dale and I and our firm were doing most of the reviews. I've reviewed his work, and we're getting a hundred percent realization rates. For our clients that want flat fee, we're getting up bills. So, it actually worked out well. Where it becomes an issue is when we say, "Okay, we'll have one staff do this, and one staff do that." Kind of like in an audit, we'll go, "Okay, you focus on the balance sheet accounts; you focus on the income statement accounts." It's all interrelated, so we typically have one team member, and it is an experienced team member.

Now it doesn't have to be a partner. Katie will be our next partner, but after she had about two or three years [of] experience, then we let her work on reviews.

People believe that's counterintuitive. They said, "Well, did you allow Katie to work on audits when she was a first year here?" Yeah. "Well, if she can work on an audit, which is reasonable assurance, certainly she can work on a review." Well, no, because in an audit we're saying compare this number with this invoice. You're not making any judgment calls. Katie is absolutely one of the smartest people I've ever met in my life, but she will tell you, just like I'll tell you about myself. When I was a first or second year CPA, there's no way I could have detected a GAAP departure by performing an inquiry, asking a question, and doing an analytical procedure. I just didn't have the depth of knowledge that I needed. Once you get to that third, fourth, fifth year, now you're there. What we do in audits, and in the bookkeeping, and the compilation, that gives us that knowledge.

I think it is a very narrow expertise field, so, limit the number of team members, but make sure they are experienced. And I agree with you. If you're a large enough firm that you can have the manager-level people do it, that's the sweet spot. When you have those experienced people—three to seven, maybe three to eight years—that's the sweet spot. But if you're a firm like ours, for a while, we didn't have those middle-level people. We just had brand-new staff and then partners. We were still—surprising to us—able to be profitable with just the partners.

What did I use the staff for? To go out and do the bookkeeping? Maybe I'll have a staff person take the client trial balance and enter it into our software if we don't have an integrated program where you can just dump the client [information]. But even then, Debi, people think that's inefficient to do some manual processes. When I'm keying in a trial balance, even when I'm doing it at my rates, I know what new accounts there are. Then I do the grouping schedule, so I know what financial statement elements that's going to affect. I don't think it's actually terribly inefficient for me to be keying in a trial balance because I'm really quick at it, and it provides me information that helps me ask questions. So again, it gets back to that you think you're being efficient by having three or four people involved, but the more we limit the number of team members, actually, the more efficient we become.

#### **Ms. Grove Casey**

So, let's talk about the types of tests that maybe you do there. Do you utilize a lot of predictive tests?

**Mr. Oestricher**

Years ago, no. We'd just print out the ratios; our trial balance software would list a bunch of ratios. But remember, analytical procedures can be trends compared to last year, financial statement ratios.

But I love the predictive tests because that's where you take non-financial data and just what I call common sense, and you apply it. Now we can get very good review evidence—and we use that term *review evidence*, which is not just indigenous to audits now—which gives tremendous coverage of big ticket items if you will.

In other words, salaries—usually a very large part of the expense component for most companies. Well, if I take salaries divided by full-time-equivalent employees—and I am a restaurant, okay—and then I break that down to hourly. Well, back in the day—let's say it's a McDonald's type where people don't get tips—back in the day that should have come out to about eight bucks an hour because most people paid minimum wage with a little increase for experience. Now what should that number be? 15 an hour--\$12 to 15. That's what they're having to pay. Think of the labor cost of a fast-food chain. By doing very targeted predictive type tests, I can get information on—and by the way, labor versus your food cost, that's a pretty big ratio or pretty big metric, if you will, that's used in that industry.

So, we use predictive tests always for revenue. Remember, you're required to perform analytical procedures for revenue [on] disaggregated data. I look at, what's the capacity of this company? The classic example is a hotel. You can take number of rooms, times average room rate, times 365 days, times occupancy rate. That gives you a great predictor of revenues, and then, once you do a couple of analytical procedures, you maybe compare it to budget or compare it to a trend from prior years. You do that predictive test. Now I can look at items like percentages of revenue that are industry-based standard on what should utilities be as a percentage or what should housekeeping cost. So, those predictive tests have provided us so much more information than just, “Oh, what's the current ratio, or what's the leverage ratio?”

Now I'm not discounting those. If there are financial statement ratios that are part of debt covenants or restrictions for bonding agreements, then absolutely you should look at those. Then look at the underlying numerator and denominator and say, “Okay, what

accounts go in the numerator and denominator? Are they subject to management estimates?” Then that's where you want to focus additional analytical procedures. So, there's still absolutely the appropriate place for ratios, but utilization of predictive tests has given us very good review evidence for a broad area of the financial statements.

**Ms. Grove Casey**

So, you mentioned that you were going to stop doing reviews if they required understanding of internal control. And that is an audit procedure that we're required to do in an audit—obviously not in a review—but let's talk about what other audit procedures you try to avoid.

**Mr. Oestricher**

Read the report where it says, “We do not contemplate confirmations, inspection, recalculate.” Follow your audit report.

**Ms. Grove Casey**

Yeah.

**Mr. Oestricher**

What we did to help us with that is we stripped away a lot of the documentation that used to be in our review engagements. It used to be if you looked at our review file, you would see lead schedules. You would see bank reconciliations that tied up to cash. You would see depreciation schedules. You'd see subsidiary schedules for receivables. We don't include that anymore in our review documentation because you're not required to. The numbers that we extract from that data—I'm probably always going to do an analytical procedure on an allowance for a doubtful account. So, I'll get some aging data from the receivables, but I just put tick marks in. This is where I obtained this data. Then I use my Excel spreadsheet to perform whatever analytical procedure.

The reason we do that is, once we put a piece of paper in the file, we can't help ourselves—we have to foot it, right? We have to trace it. We have to look for old or unusual reconciling items. So, the way that we do this—once we look at our review documentation, if you have any documentation that supports an amount that's reflected in the trial balance and then up to the financial statements, you need to tell me—because I'm reviewing the reviews in our firm—what inquiry or analytical

procedure did not come within your expectations that led you to believe that, “Hey, I’ve got to make a copy of this now, and I’ve got to perform further procedures that are not contemplated, but you can do.” That’s why we say these procedures are not prohibited in a review; they’re just not contemplated.

But, I mean, if my days in inventory are out of whack, and my gross profit percentages are out of whack, and, based on my inquiries, I find out that they changed inventory systems for the year. I wish I was lying to you or making this up or embellishing, but I’m not. One year on inquiries my client said, “Yeah, we had our inventory, but we scheduled it for a certain day not realizing that LSU was going to have an afternoon bowl game that day. The people that did show up had had a little adult beverage. So, it didn’t go as well as we had expected.” Nothing was matching up the way it should be, and that’s when we started looking at the underlying transactions and looking at the general ledger to find [out if there] was a cutoff problem. So, that year you saw audit-like procedures, but there was a reason. I didn’t say because there was a bunch of drunk idiots counting inventory, but I said it in the nicest way possible. I inferred that in the nicest way possible. I think LSU did win the bowl game that year so it was all worth it.

So, only perform those procedures when necessary, and then don’t put workpapers or documentation in your review that would even tempt you to perform those audit procedures. There has to be a reason for every one.

**Ms. Grove Casey**

In the past, materiality was something that we calculated in an audit engagement. What’s the story with it in reviews?

**Mr. Oestrieher**

Well, that’s one of the big changes with SSARS No. 25. We now have to calculate materiality, but this is the proverbial dog that caught the car.

**Ms. Grove Casey**

We have it, and what do we do with it?

**Mr. Oestrieher**

What do we do with it, right? And say, we’ll use it in designing your review procedures. Well, I can honestly tell y’all, I’ve never had to have that number to figure

out [that] these are the right questions to ask these people. Then I’m going to perform analytical procedures on these key elements because they’re subject to a new GAAP requirement, I’ve seen issues in the past, they’re subject to management estimate, or whatever reason I believe that we needed to perform analytical procedures in any one particular area.

That materiality cap didn’t change all that. So, don’t now come up with this number and come up with a ridiculously low materiality amount, and now believe, “Oh, I have to perform a specific analytical procedure on every account or every general ledger account that’s above this threshold.” You don’t okay? You don’t.

Remember, first of all, do the work at the financial statement level, not the account level. But, even more importantly, understand we have always and will always continue—unless the standards are changed—to perform at least one analytical procedure on every element of the financial statements, and that’s the comparison to prior years. And there are enough general inquiries about are there unrecorded liabilities and items, that you’re hitting inquiries. So don’t believe that, “Oh, I have to do additional analytical procedures on any account that’s over \$17,000 if that’s what I come up with.” So, it’s there. The materiality number is there, but it does not mean you have to go add specific procedures.

So, don’t become beholden to that materiality calculation again. And that’s a new thing because we’re just into our first year now of having to do that. That was a warning that I had [to give] to my staff: don’t overdo it just because you have this number. We’ve had appropriate inquiry and analytical procedures in the past.



### Efficiencies in Review Engagements

by Kurt Oestrieher, CPA

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There is a wide variance of procedures performed and documented in firms for review engagements. This is due to the large amount of professional judgment that is allowed in a review engagement under the Statements on Standards for Accounting and Review Services (SSARS). However, because assurance is provided, some firms are not comfortable performing the minimum requirements under SSARS. Some firms treat a review as a “mini-audit,” while other firms take a minimalist approach. Both are within standards, but the “mini-audit” approach may lead to inefficiencies.

While an entity may choose any financial reporting framework for financial statement purposes, we will reference United States GAAP in this discussion because most reviewed financial statements are United States GAAP. However, if you are reviewing an entity that is using a different framework, such as IFRS, IFRS for SMEs, or FRF for SMEs, the same principles for efficiencies will apply.

The following issues should be considered by a firm when structuring review engagements so that not only are standards followed (which is most important), but the engagements are also profitable for the firm:

- Review financial statements, not trial balances
- Do not perform bookkeeping procedures
- Limit the number of accountants on the review team
- Not utilizing predictive tests
- Avoid audit procedures
- Materiality documentation

All of these issues are considered in detail in this discussion. As you are reviewing the issues, compare them to the procedures that are currently in place in your firm to determine if changes are necessary. By design, the review procedures required by AR-C 90 are flexible, so it is important to always remember the objective of a review engagement:

“To obtain *limited assurance* as a basis for reporting whether an accountant is aware of any material modifications that should be made to the financial statements for them to be in accordance with the applicable financial reporting framework, *primarily* through the performance of *inquiry* and *analytical* procedures.”

*Limited assurance*—As accountants, we are conditioned to think in black and white. It is either right or wrong; there is no in-between, and no philosophical discussions should be engaged in to determine whether or not two plus two actually equals four. While this attitude serves us well in many of our engagements, it can hinder us in review engagements. By definition, a review engagement provides less assurance than an audit engagement. This means that even if a framework departure exists, we may not become aware of such a departure or modify our report *even if we comply with all of the requisite standards*. This confuses most of us because we cannot comprehend the fact that even if the financial statements are wrong (i.e., a material framework departure exists), our report can still be correct (no modification for the framework departure). Now, two plus two does *not* equal four and our heads explode.

If every set of financial statements that was accompanied by a report from a CPA had the expectation that absolute assurance was provided, we would not have four levels of service (audit, review, compilation, and preparation). We would only have one level of service which will never be defined (absolute assurance) because absolute assurance is unachievable. We, therefore, must accept that the *limited assurance* provided in a review is less assurance than the *reasonable assurance* provided in an audit. We can now become more comfortable that we are not designing our review engagement to detect every GAAP departure that may be present, but instead we are designing our review procedures so that our report meets the objectives of a review engagement notated in AR-C 90.

*Primarily inquiry and analytical procedures*—Most of us know the definition of primary, but do we truly make inquiry and analytical procedures our primary

procedure to provide limited assurance in a review engagement? After critical analysis, many firms have determined that the primary procedures employed were tying every balance sheet account to a schedule, performing audit-like procedures on those schedules, and testing transactions throughout the reporting period. After these procedures were performed and the accountant “felt comfortable” that all departures had been discovered, cursory inquiry and analytical procedures were performed. Were these types of engagements within standards? Probably, as long as the minimum inquiries and analytical procedures required by AR-C 90 were performed. Were these engagements performed in the most efficient manner? Probably not.

By reviewing the objectives of the engagement, which are contained in both the engagement letter and the report, an accountant can better understand if the procedures performed achieve the objective of the engagement. Do not review to the perceived expectations of third parties or regulators; review to the stated objectives of SSARS.

### **Review Financial Statements, Not Trial Balances**

AR-C Section 90 is titled “Review of Financial Statements,” yet it is common for accountants to perform review procedures on the amounts included in a trial balance (which is permitted under standards) rather than the financial statements. By using this approach, the accountant is focusing on measurement of GAAP issues, instead of the financial statements which include presentation and disclosure GAAP requirements. By focusing on GAAP measurement, the following parts of the financial statement will not be subject to review procedures until later in the engagement:

- Statement of cash flows
- Notes to the financial statements
- Statement of changes in equity
- Classification between current and noncurrent assets and liabilities

If the accountant believes that no journal entries will be required as a result of the engagement, he or she should consider assisting the client in writing the financial statements before review procedures are applied. This will allow the accountant to have all of the financial

statements available for analytical procedures, including the statement of cash flows. This approach will also bring potential disclosure issues to the attention of the accountant at an early stage, rather than when the disclosure checklist is completed (usually very close to the deadline).

Another efficiency gained by reviewing at the financial statement level rather than the trial balance is that the accountant is focusing on the elements of the financial statement and not the underlying accounts. Many times an accountant may get side-tracked by analyzing a fluctuation in an account that is classified as an other current liability, when that account is actually grouped with several other accounts to make up the line item “other current liabilities.” When performing analytical procedures at the financial statement level, the variance may not be an issue, so time is saved by not tracking down the individual variances. If the analytical procedure at the financial statement level indicates unexplained variances, then breaking the financial statement element down to the account level can be a response.

### **Do Not Perform Bookkeeping Procedures as Part of the Review Engagement**

If you determine through preliminary inquiries that it is likely your client needs assistance in closing and adjusting their general ledger, send a person to perform this service prior to beginning the review. If possible, the person who assists with bookkeeping should not be a part of the review team. This will help the review team from being prejudiced when developing expectations for analytical procedures. This engagement will usually be considered a separate engagement from the review, and the accountant may want to issue a separate engagement letter. This engagement will not result in compiled or prepared financial statements under SSARS, because the finished product will be a trial balance, which is not a financial statement.

While assisting the client in adjusting and closing the books, it is important to remember that the resulting accounting records, such as depreciation schedules, prepaid schedules, amortization schedules, topside entries, etc., are a part of the client’s accounting records and not work papers to be retained by the accounting firm that is assisting the client. Furthermore, if the accountant is utilizing software that the accountant owns for depreciation, care should be taken to ensure that the client has a copy of the depreciation schedule

and any other accounting record. Failure to do so could cause independence impairment because the accounting firm would otherwise be hosting under ET 1.295.143.

The client should be billed separately for this engagement so that the firm and the client understand that this assistance is not part of the review engagement, but is necessary because the client does not have a person with the expertise to close the books. This does not preclude the client from having an individual with suitable skill, knowledge, or experience (SKE) to oversee the bookkeeping engagement. The Professional Ethics Executive Committee (PEEC) is very clear that the individual with suitable SKE does not need to know how to perform or re-perform the services provided but, instead, must be able to understand what was done and accept responsibility for the services. By treating this as a separate engagement, the review documentation of the accounting firm does not become cluttered with bookkeeping work papers, which tend to expand into unnecessary and inefficient procedures.

### **Limit the Number of Accountants on the Review Team**

Most small business reviews can be performed by a single accountant and, then, reviewed by another accountant. Because detail testing is not required in a review, it makes sense to have one person perform all of the inquiries and analytical procedures since these two procedures are interrelated.

Detecting potential GAAP departures using only analytical procedures and inquiries requires a great deal of experience and knowledge, so care should be used when assigning staff. In most cases, a review should be handled by more experienced staff. This is counterintuitive because we use staff on audits and audits provide a higher degree of assurance. If staff are good enough for audits, then why are they not good enough for reviews? The answer is simple: it takes more experience to properly perform analytical and inquiry procedures. The following is a discussion of the difficulties that inexperienced staff have in performing analytical procedures and inquiries.

### ***Analytical procedures***

While new staff may understand how to calculate ratios, do they truly understand the relationship between the ratios and potential GAAP departures?

Depending on the educational background and prior experience of new staff, the answer is, “maybe.” Realistically, if a staff member who has less than one year of experience is asked to calculate ten ratios, the staff person will perform the calculation correctly and arrive at the correct amount. However, the following issues should be considered:

- What basis did the staff person use to develop his or her expectations?
- Did the staff person calculate ratios that would be useful in detecting GAAP departures?
- Was there an appropriate mix of analytical procedures performed (e.g., ratio, trend, predictive)?

### ***Inquiries***

Inquiries are an even more dangerous area when utilizing new staff. Many firms use canned inquiry programs that are broken down in the following areas:

- Cash and cash equivalents
- Receivables
- Inventory
- Other current assets
- Property, plant, and equipment
- Other assets
- Accounts payable
- Other current liabilities
- Long-term debt
- Income taxes
- Revenues
- Cost of sales
- Expenses
- Fraud
- Commitments and contingencies



- Related-party transactions
- Going concern
- Other disclosures

While utilizing such checklists is very useful and recommended, utilizing new staff to ask these questions may lead to inefficiencies and/or ineffective procedures. Most new staff can ask the questions and document the answers from management. The potential problem lies in the ability of the new staff to understand whether follow-up questions should be asked, and how the responses of management relate to the results of the analytical procedures. Without the proper experience, staff tend to resort to audit procedures to determine if GAAP departures may exist. As discussed in a future section, this is one of the most significant issues related to inefficiencies in a review engagement.

Most staff will become very adept at performing reviews after they have two to three years of experience working on audits and compilations. They will also gain experience assisting the client in preparing the financial statements, and this is one area where they can assist in a review early in their careers. As mentioned earlier, it is better to write the financial statements as early as possible in a review engagement—preferably by someone who is not going to perform the inquiry and analytical procedures. This is a great opportunity for staff to obtain valuable experience in a review engagement, without having them involved in the actual review procedures.

### Utilize Predictive Tests

The standards and guidance issued by the AICPA reference many types of analytical procedures that can be utilized in a review engagement, including predictive tests. Because it is easy to calculate ratios (and this is often done automatically by the trial balance software) and to compare to industry data, accountants sometimes will calculate far too many ratios, many of which are not designed to detect GAAP departures. While predictive tests do take longer to develop and calculate, often they are far more powerful in detecting GAAP departures.

Let's use an example of a review engagement of an entity that owns and operates a hotel. Because an accountant is required to perform analytical procedures on revenues, many times a firm may compare to prior years or budgets to satisfy this requirement. However,

like most industries, hotels have a finite revenue limit that is based on occupancy. An expectation for revenues can be developed by defining the following:

- Number of rooms
- Average revenue per room
- Expected occupancy
- Number of days in the year

Two of the factors are definite (number of rooms and 365 days per year). The average room revenue and expected occupancy can be estimated by historical average, or industry average if it is a new entity. By using these factors to develop an expectation, the accountant has a high degree of reliance on this analytical procedure. This same model can be used for restaurants, bars, and other revenue streams of the entity. Once revenues are established, many expenses can be predicted as a percentage of revenue (maid service, supplies, utilities, and other variable costs). Other salary and related expenses can be predicted based on the number of employees, and interest expense can be predicted by average debt. Most of the remaining expenses, such as property taxes and depreciation, can be analyzed by trend analysis.

By employing predictive tests for revenues, many of the elements of the income statement can be covered with a higher degree of reliance than just trend or ratio analysis. The results of these tests can be compared with previous years in order to gain even more efficiency.

### Avoid Audit Procedures

A common inefficiency in review engagements is having a work paper "tie up" to each material account on the balance sheet. This is not required in a review, but the tendency to include these types of work papers encourages performing audit-type procedures such as footing, recalculation, and tracing. Not only are the performance of these procedures a waste of time, inconsistency in the application of procedures from one account to another may call into question the reasonableness of certain procedures that are performed. There should be a reason when any procedure other than inquiries and analytical procedures are performed, and that reason is that either inquiries, analytical procedures, or both, indicated that a GAAP departure may be present.

Accountants often have the misconception that they must gather evidence in their review documentation to support the responses of management to inquiries. In fact, the opposite is true. AR-C 90.30 states, “The accountant is not required to corroborate management’s responses with other evidence.” Because of the mistaken belief that we must corroborate management’s responses, our review documentation becomes cluttered with bank reconciliations, subsidiary schedules, depreciation schedules, and other support documentation that is not necessary. Once we have that documentation in our files, we now believe it is our duty to “do some work on the documentation,” so we start looking for unusual items on the bank reconciliation, foot schedules, and perform other unnecessary work. The combined effect is wasted time, not only performing procedures that are not necessary, but time must be spent to review the unnecessary work and, in the worst-case scenario, errors or incorrect assumptions that are documented could come back to haunt the accounting firm in litigation.

Most firms have far too much documentation in their review files. Carefully consider each piece of documentation and how it fits within the *requirements* of a review engagement. If the documentation does not support a procedure that is required, consider eliminating the procedures that you are performing and the related documentation.

### Materiality

AR-C 90.19 requires that an accountant determine materiality in a review engagement and apply materiality in designing the review procedures and evaluating the results of review procedures. There is no specific methodology outlined in the SSARS that an accountant must use in determining materiality, and most accountants will use the same conventions that are used in determining planning materiality for audit engagements.

It is not mandatory that all account balances above the calculated materiality have a specific type of analytical procedure performed. All account balances are subject to the mandatory comparison with prior periods. If the prior period balances are within expectations, and the account balances are not subject to complex framework reporting requirements or management judgment, the author believes that an accountant may use his or her professional judgment to determine that additional analytical procedures are not necessary.

### Summary

Review engagements are becoming more common in the small business environment. As more firms are engaged to perform review services, it is vital that accountants understand the specific requirements of a review and not perform procedures that are not required—which not only leads to inefficiencies, but also can trap the accounting firm in litigation when the client perceives that a higher level of service is being provided than the review engagement. Any accountant who is performing a review engagement should thoroughly read AR-C 90 and be familiar with the AICPA guides on performing preparation, compilation, and review engagements. These are the authoritative sources of guidance on review engagements and should be consulted when there is a question concerning the nature and extent of review procedures.



## GROUP STUDY MATERIALS

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### A. Discussion Problems

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1. How can acceptance of the *limited assurance* objective of a review engagement noted in AR-C 90 help auditors become more comfortable with their design of review procedures?
2. Discuss how review of financial statements, instead of trial balances, creates efficiency.
3. Discuss the advantages of utilizing predictive tests for revenues, as opposed to calculating ratios.

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## B. Suggested Answers to Discussion Problems

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1. As accountants, we are conditioned to think in black and white. It is either right or wrong; there is no in-between, and no philosophical discussions should be engaged to determine whether or not two plus two actually equals four. While this attitude serves us well in many of our engagements, it can hinder us in review engagements. By definition, a review engagement provides less assurance than an audit engagement. This means that even if a framework departure exists, we may not become aware of such a departure or modify our report *even if we comply with all of the requisite standards*. This confuses most of us because we cannot comprehend the fact that even if the financial statements are wrong (i.e., a material framework departure exists), our report can still be correct (no modification for the framework departure). Now, two plus two does *not* equal four and our heads explode.

If every set of financial statements that was accompanied by a report from a CPA had the expectation that absolute assurance was provided, we would not have four levels of service (audit, review, compilation, and preparation). We would only have one level of service which will never be defined (absolute assurance) because absolute assurance is unachievable. We, therefore, must accept that the *limited assurance* provided in a review is less assurance than the *reasonable assurance* provided in an audit. We can now become more comfortable that we are not designing our review engagement to detect every GAAP departure that may be present, but instead we are designing our review procedures so that our report meets the objectives of a review engagement notated in AR-C 90.

2. It is common for accountants to perform review procedures on the amounts included in a trial balance (which is permitted under standards) rather than the financial statements. By using this approach, the accountant is focusing on measurement of GAAP issues, instead of the financial statements which includes presentation and disclosure GAAP requirements. By focusing on GAAP measurement, multiple parts of the financial statement will not be subject to review procedures until later in the engagement.

If the accountant believes that no journal entries will be required as a result of the engagement, he or she

should consider assisting the client in writing the financial statements before review procedures are applied. This will allow the accountant to have all of the financial statements available for analytical procedures, including the statement of cash flows. This approach will also bring potential disclosure issues to the attention of the accountant at an early stage, rather than when the disclosure checklist is completed (usually very close to the deadline).

Another efficiency gained by reviewing at the financial statement level rather than the trial balance is that the accountant is focusing on the elements of the financial statement and not the underlying accounts. Many times an accountant may get side-tracked by analyzing a fluctuation in an account that is classified as an other current liability, when that account is actually grouped with several other accounts to make up the line item “other current liabilities.” When performing analytical procedures at the financial statement level, the variance may not be an issue, so time is saved by not tracking down the individual variances. If the analytical procedure at the financial statement level indicates unexplained variances, then breaking the financial statement element down to the account level can be a response.

3. The standards and guidance issued by the AICPA reference many types of analytical procedures that can be utilized in a review engagement, including predictive tests. Because it is easy to calculate ratios (and this is often done automatically by the trial balance software) and to compare to industry data, accountants sometimes will calculate far too many ratios, many of which are not designed to detect GAAP departures. While predictive tests do take longer to develop and calculate, often they are far more powerful in detecting GAAP departures, for example, in the case of an entity that owns and operates a hotel with a finite revenue limit that is based on occupancy.

By employing predictive tests for revenues, many of the elements of the income statement can be covered with a higher degree of reliance than just trend or ratio analysis. The results of these tests can be compared with previous years in order to gain even more efficiency.

## GLOSSARY OF KEY TERMS

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**Analytical Procedures**— evaluations of financial information made by a study of plausible relationships among both financial and nonfinancial data. Analytical procedures range from simple comparisons to the use of complex models involving many relationships and elements of data, varying from comparisons to ratios to trend analysis

**Component Auditor**—An auditor performing work on the financial information of a component that will be used as audit evidence in a group audit

**Deferred Taxes**— the difference between the tax amount arrived at from the book profits recorded by a company and the taxable income.

**Going Concern**— the assumption that an entity will remain in business for the foreseeable future.

**Income Tax Expense**— the total amount of taxes owed by an individual, corporation, or other entity to a taxing authority. Income tax expense is arrived at by multiplying taxable income by the effective tax rate.

**Inquiry**— seeking information from knowledgeable persons in financial or nonfinancial roles within the company or outside the company

**Lead Auditor**—Auditor who plans and performs audits that involve other accounting firms and individual accountants

**PCAOB**—Public Company Accounting Oversight Board

**Quality Control**— a process to provide the firm with reasonable assurance that its personnel comply with applicable professional standards and the firm's standards of quality.

**Referred-to Auditor**— when part of an audit is performed by a different audit firm and that auditor (not the principal auditor) is referred to in the lead auditor's report, the auditor is called the referred to auditor



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<b>Speaker</b>	<b>Month</b>	<b>Speaker</b>	<b>Month</b>
Jennifer Louis .....	Jan-Feb	Russ Madray.....	Jan-Feb
Kurt Oestrieher .....	Feb		

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

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1. According to Russ Madray, information provided on the face of the financial statements is which of the following?
  - A. extensive.
  - B. limited.
  - C. explanatory.
  - D. narrative.
  
2. According to Russ Madray, what is the primary reason the three components that make up the deferred tax balance must be disclosed in the notes to the financial statements?
  - A. The valuation allowance for deferred tax assets is included on the balance sheet.
  - B. Qualitative information about deferred taxes is more important than quantitative information.
  - C. ASC 740 prohibits temporary differences from being included on the balance sheet.
  - D. The entity's deferred taxes are required to be presented net on the balance sheet.
  
3. According to Russ Madray, disclosing a change in tax status when it occurs after year end, but prior to issuance of the financial statements is what type of disclosure?
  - A. Deferred tax.
  - B. Rate reconciliation.
  - C. Subsequent event.
  - D. Temporary difference.
  
4. According to Russ Madray, public companies need to disclose all components that equal or exceed what percentage of the gross deferred tax asset or deferred tax asset liability?
  - A. 5%.
  - B. 7%.
  - C. 10%.
  - D. 12%.
  
5. According to Russ Madray, related to consolidated tax groups, what is the correct term for an entity that is **not** subject to income tax?
  - A. Consolidated entity.
  - B. Deferred entity.
  - C. Disregarded entity.
  - D. Reporting entity.

*Continued on next page*

6. According to Jennifer Louis, what is a *referred-to auditor*?
  - A. One who uses the work of other auditors.
  - B. One who participates in a global audit.
  - C. One whose work is referenced by the lead auditor.
  - D. One who performs engagement quality control reviews.
7. According to Jennifer Louis, when making reference to the work of other audit firms, lead auditors need to do which of the following to comply with the new PCAOB standards?
  - A. Get written independence and licensure representations from the other firm.
  - B. Trust that the other firm performed all the necessary audit procedures.
  - C. Take ownership for the other firm's quality control.
  - D. Withdraw from any engagement that will be a multi-tiered audit.
8. According to Jennifer Louis, what is the overarching mission of the PCAOB?
  - A. To keep current audit procedures consistent with those used in the past.
  - B. To protect the public interest and investors by advancing audit quality.
  - C. To provide complete assurance that quality control standards are upheld.
  - D. To match the quality management rules provided by the IAASB.
9. According to Jennifer Louis, what is the PCAOB's focus related to compliance with laws and regulations?
  - A. Expert testimony.
  - B. Illegal acts.
  - C. Noncompliance.
  - D. Nonpublic entities.
10. According to Jennifer Louis, which of following statements best describes how the PCAOB is addressing the use of technology in audits?
  - A. Because fraud is typically perpetrated by individuals, the PCAOB focuses on technology in relation to issues other than fraud.
  - B. The PCAOB limits its discussion of technology to small scale issues, such as how it affects substantive analytical procedures.
  - C. The PCAOB is examining the big picture of how innovative technology is affecting the quality of audits.
  - D. As technology has not changed much lately in relation to audits, addressing it is not high on the PCAOB's agenda.

*Continued on next page*

11. According to Kurt Oestrieher, recent standard changes have made reviews more like which of the following engagement types?
  - A. Audit engagements.
  - B. Bookkeeping engagements.
  - C. Compilation engagements.
  - D. Preparation engagements.
12. According to Kurt Oestrieher, how does the limited assurance provided in a review differ from the level of assurance provided in an audit?
  - A. Reviews are typically more likely to find GAAP departures than audits.
  - B. Reviews are similar in scope and just as likely as audits to find GAAP departures.
  - C. Reviews are only slightly less likely than audits to find GAAP departures if CPAs are detailed enough.
  - D. Reviews are substantially different from audits and much less likely to find GAAP departures.
13. According to Kurt Oestrieher, which of the following actions allows CPAs to perform more efficient reviews?
  - A. Waiting to prepare the financial statements until after the review is complete in case amounts change.
  - B. Reviewing data at the financial statement level instead of reviewing the trial balance.
  - C. Avoiding preparing the client's financials even if they have an in-house accountant to approve them.
  - D. Using the classifications and other work done by in-house accountants that are not CPAs without modification.
14. According to Kurt Oestrieher, what is the most efficient way to allocate staff members to review engagements?
  - A. First and second year staff members should perform reviews, which will give them the experience they need to work on audit engagements in the future.
  - B. Partners should never perform review engagements because their hourly rate is too high to keep most review engagements profitable.
  - C. Management-level staff members with three to eight years of experience are best suited to perform reviews.
  - D. Review procedures should be divided up between multiple staff members and partners, so they are completed in the shortest amount of time.
15. According to Kurt Oestrieher, how does the SSARS No. 25 requirement to calculate materiality affect review engagements?
  - A. More analytical procedures are required to be performed on accounts that are above that threshold.
  - B. It will help CPAs determine what questions to ask to get the most appropriate evidence from the client.
  - C. It means that CPAs need to perform review work at the account level instead of the financial statement level.
  - D. The materiality amount is there, but CPAs do not have to add specific procedures as a result of it.



## 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](mailto:CPLgrading@thomsonreuters.com).

How would you rate the topics covered in the February 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
ASC 740 Income Tax Disclosures	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Recent PCAOB Auditing Standards Activity	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Efficiencies in Review Engagements	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

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

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

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

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How would you rate the effectiveness of the speakers in the February 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	_____	_____	_____
Jennifer Louis	_____	_____	_____
Kurt Oestrieher	_____	_____	_____

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

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\_\_\_\_\_

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

<b>Course Title</b>	
<b>Course Date:</b>	
<b>Start Time:</b>	
<b>End Time:</b>	
<b>Moderator Name, Credentials, and Signature Attestation of Attendance:</b>	
<b>Delivery Method:</b>	Group Internet Based
<b>Total CPE Credit:</b>	3.0
<b>Instructions:</b>	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.
<b>Brief Description of Method of Polling</b>	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](mailto:CPLgrading@tr.com)

**Fax:** 888.286.9070

**When sending your package to Thomson Reuters, you must include ALL of the following items:**

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

**Incomplete submissions will be returned to you.**

# “Group Internet Based” Format

## CPE Credit

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

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

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

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

## Advertising / Promotional Page

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

## Monitoring Attendance in a Webinar

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

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



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

Examples of polling questions:

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

#### **Additional Notes on Monitoring Mechanisms:**

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

#### **Real Time Moderator During Program Presentation**

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

during the presentation). This can be achieved via the webinar chat box, and/or by unmuting participants and allowing them to speak directly to the moderator.

### **Make-Up Sessions**

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

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

### **Awarding CPE Certificates**

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

### **Subscriber Survey Evaluation Forms**

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

## Retention of Records

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

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

## Finding the Transcript

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

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

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

## Requesting Participant CPE Certificates

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

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

**Email:** [CPLgrading@tr.com](mailto:CPLgrading@tr.com)

**Fax:** 888.286.9070

**When sending your package to Thomson Reuters, you must include ALL the following items:**

<b>Form Name</b>	<b>Included?</b>	<b>Notes</b>
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:

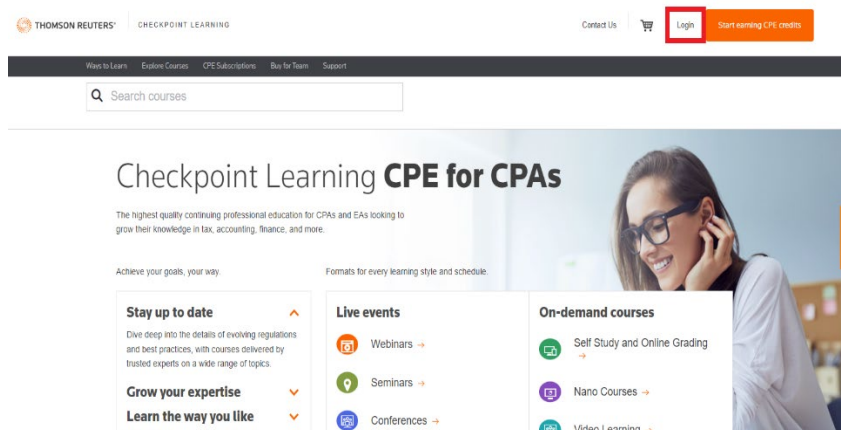
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

**Thomson Reuters**  
**PO Box 115008**  
**Carrollton, TX 75011-5008**

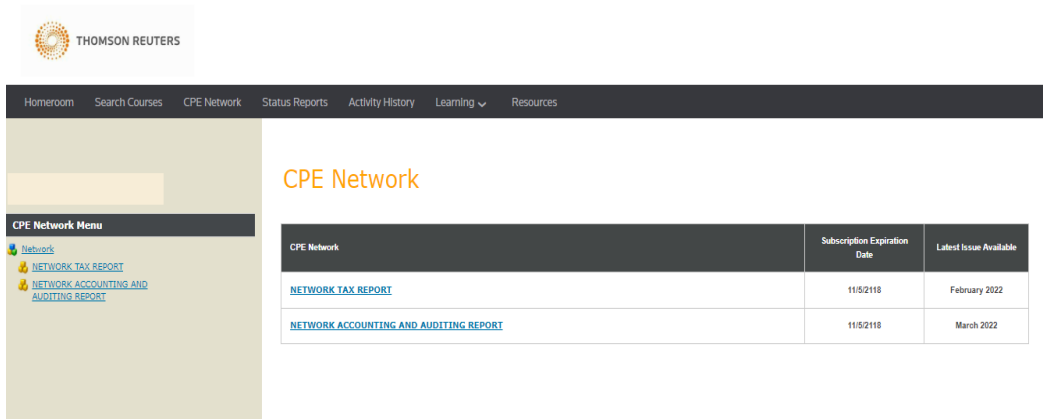
## Self-Study—Online

Follow these simple steps to use the online program:

- Go to [www.checkpointlearning.thomsonreuters.com](http://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”).

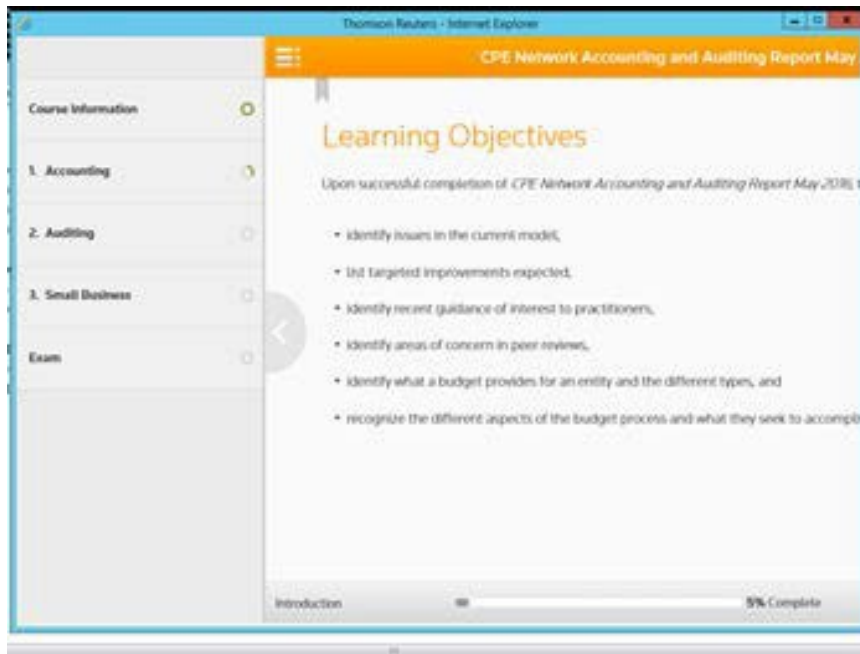


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



CPE Network	Subscription Expiration Date	Latest Issue Available
<a href="#">NETWORK TAX REPORT</a>	11/5/2118	February 2022
<a href="#">NETWORK ACCOUNTING AND AUDITING REPORT</a>	11/5/2118	March 2022

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



Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2018

## Learning Objectives

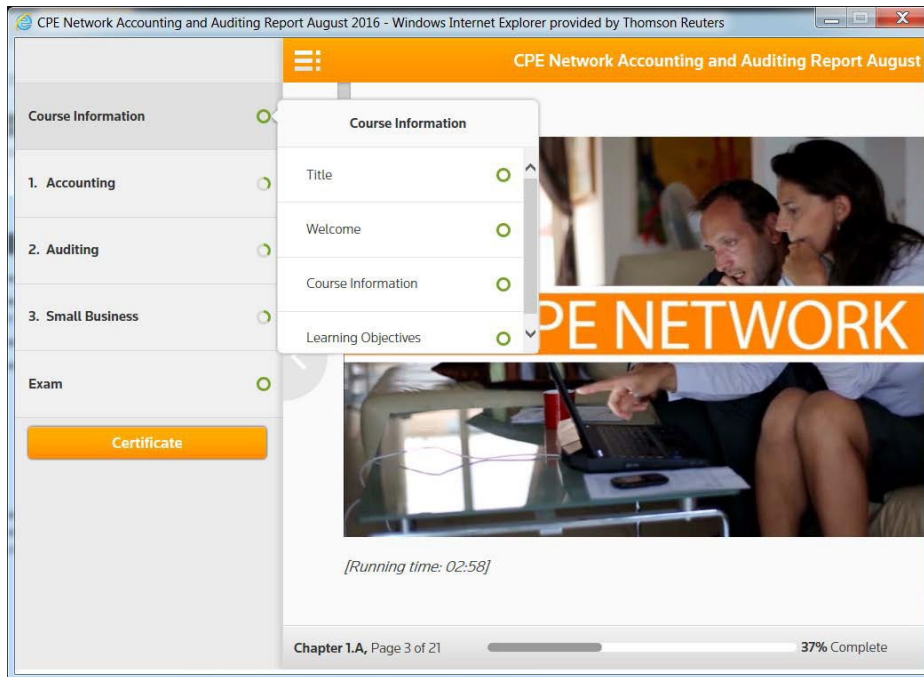
Upon successful completion of *CPE Network Accounting and Auditing Report May 2018*:

- identify issues in the current model;
- list targeted improvements expected;
- identify recent guidance of interest to practitioners;
- identify areas of concern in peer reviews;
- identify what a budget provides for an entity and the different types; and
- recognize the different aspects of the budget process and what they seek to accomplish.

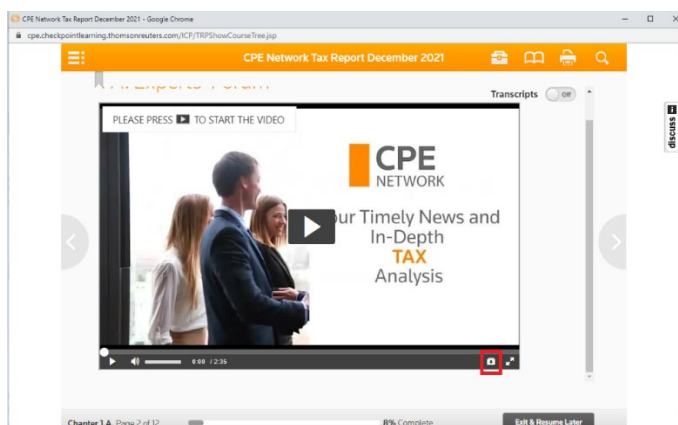
Introduction 5% Complete

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

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.

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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](#)

**STUDENT ANALYSIS AND COMMENTARY**

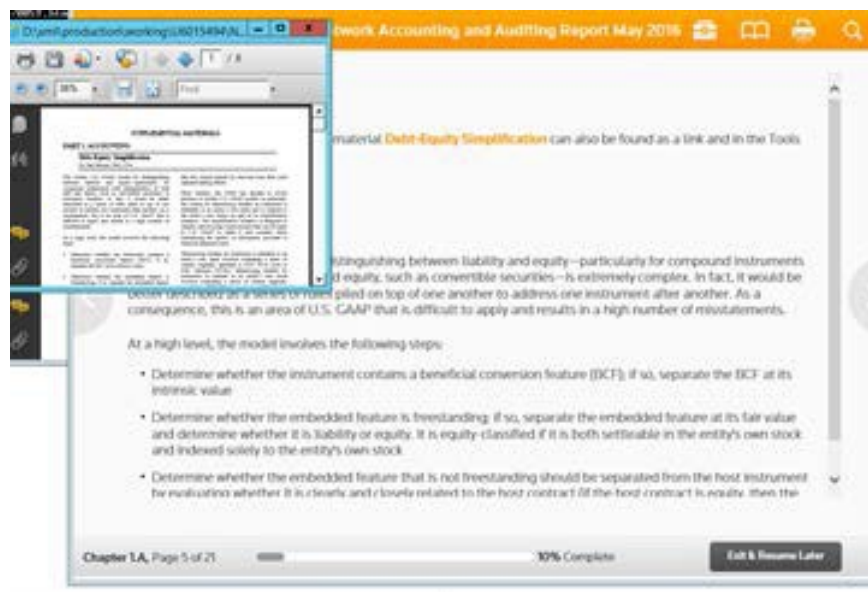
**CHAPTER 1: ACCOUNTING**

**Liabilities and Equity: Another Look at the Model**

The video in this segment discusses the 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. The video discusses the 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. The video discusses the 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.



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 and 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.

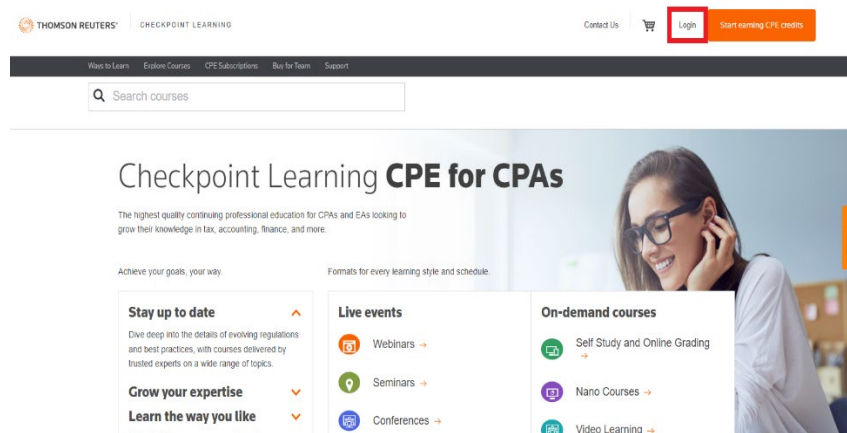
### **Print**

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**.

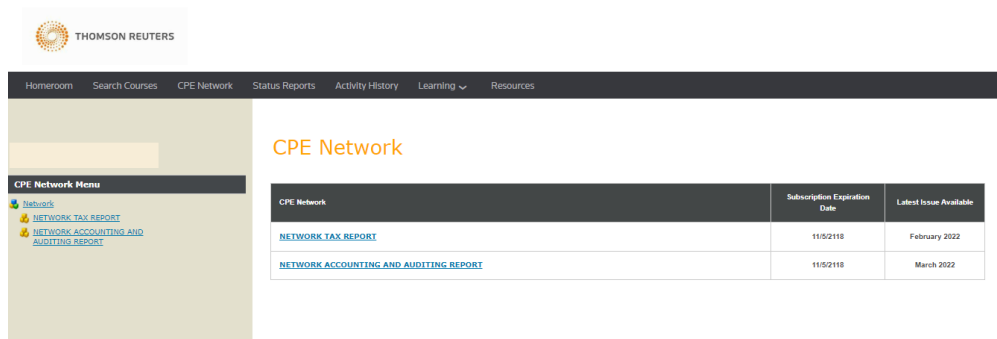
# Transitioning From DVDs

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

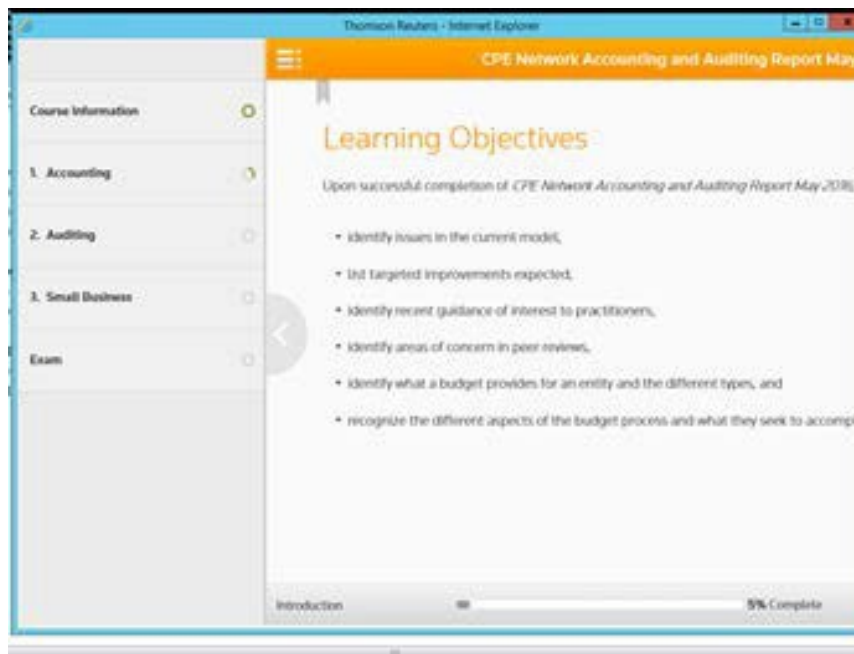
- Go to [www.checkpointlearning.thomsonreuters.com](http://www.checkpointlearning.thomsonreuters.com) .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login or Register").



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

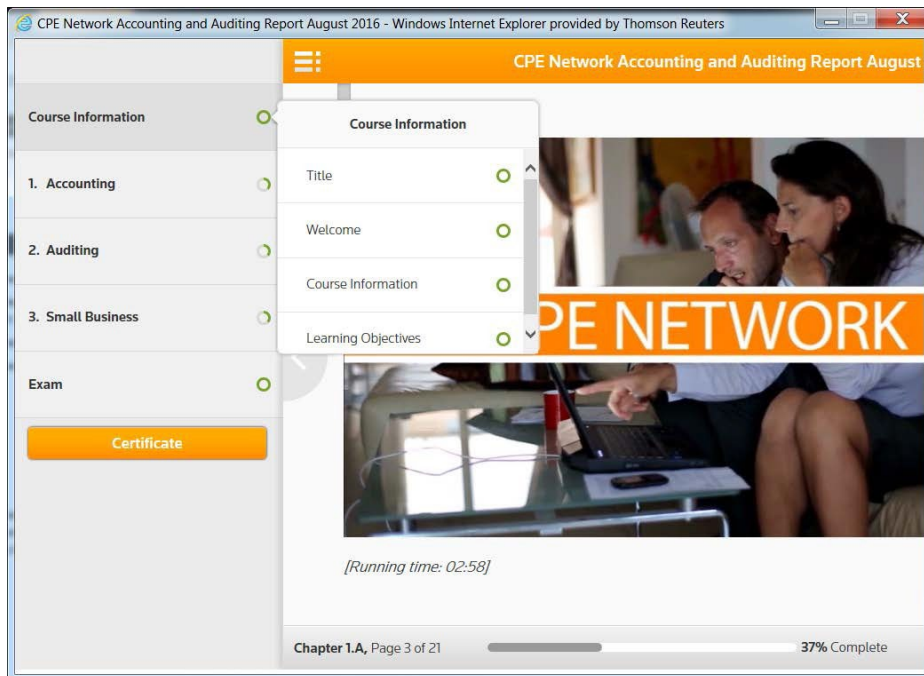


The Chapter Menu is in the gray bar at the left of your screen:

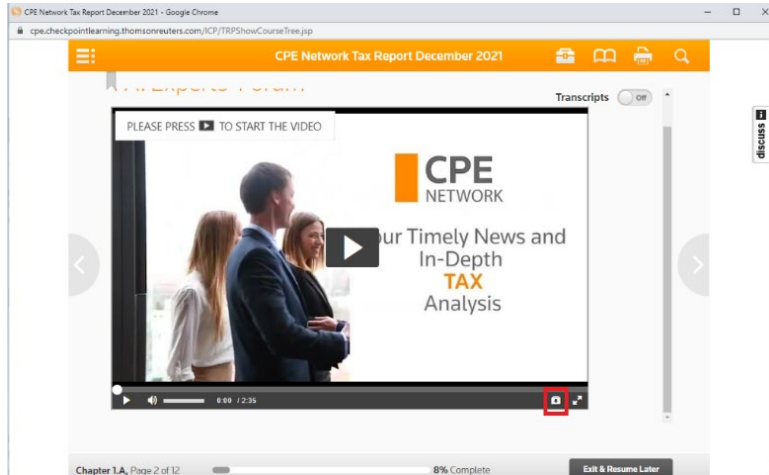


Click down to access the dropdown menu and move between the program Chapters.

- **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.

<b>Delivery Method</b>	<b>Form Name</b>	<b>Location</b>	<b>Notes</b>
"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"><li>• Browser-based</li><li>• Certificate discrepancies</li><li>• Accessing courses</li><li>• Migration questions</li><li>• Feed issues</li></ul>
Product Support	800.431.9025 (follow option prompts)	checkpointlearning.productsupport@thomsonreuters.com	<ul style="list-style-type: none"><li>• Functionality (how to use, where to find)</li><li>• Content questions</li><li>• Login Assistance</li></ul>
Customer Support	800.431.9025 (follow option prompts)	checkpointlearning.cpecustomerservice@thomsonreuters.com	<ul style="list-style-type: none"><li>• Billing</li><li>• Existing orders</li><li>• Cancellations</li><li>• Webinars</li><li>• Certificates</li></ul>