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Topics for future editions may include:

- FASB Update
- Audit issues for businesses receiving government assistance



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EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Personal Financial Statements.....3

Russ Madray, CPA discusses FASB guidance on personal financial statements. [*Running time: 42:18*]

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

- Identify the primary statements, basis of measurement, and guidance for personal financial statements
- Identify the measurement methods used for various assets and liabilities in personal financial statements
- Identify the unique requirement related to taxes in personal financial statements

PART 2. AUDITING

SAS 14525

Jennifer Louis, CPA considers recent guidance on SAS 145 and the changes to AU-C 315 related to risk assessment. [*Running time: 37:40*]

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

- Identify the percentage of matters for further consideration that arose from deficiencies in risk assessment procedures by the auditor in 2020
- Determine the effective date of the guidance
- Identify requirements to better identify and assess audit risk
- Define indirect and direct controls
- Identify how the COSO internal control components match to the new definitions related to types of controls

PART 3. SMALL BUSINESS

Analytical Procedures in Review Engagements ... 45

Kurt Oestrieher, CPA, discusses the use of analytical procedures in review engagements. [*Running time: 30:57*]

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

- Identify required analytical procedures in a review engagement and how many are typical
- Identify the guidance requiring sufficient, appropriate review evidence
- Determine documentation requirements related to expectations used in analytical procedures
- Identify important considerations related to compliance with standards

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.

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Instructional delivery method	Group Live
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Program Level	Update
Prerequisites (Circle One)	<ul style="list-style-type: none">Basic Accounting and Auditing professional experienceBasic Tax professional experienceBasic Governmental professional experience
Advance preparation	None required
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PART 1. ACCOUNTING

Personal Financial Statements

Personal financial statements are prepared for individuals either to formally organize and plan their financial affairs or for specific purposes like obtaining credit, income tax planning, retirement planning, et cetera. Personal financial statements include the financial statements of an individual or a group of related individuals, such as a husband and wife or a family.

Prior to 1982, historical cost was the primary basis of measurement for personal financial statements. However, the increasing use of personal financial statements suggested the need to reassess those conclusions in light of the purposes for which personal financial statements are prepared, the users to whom they are directed, and the ways in which they are used. AICPA Statement of Position 82-1, *Accounting and Financial Reporting for Personal Financial Statements*, was the result of that reassessment.

For a closer look at personal financial statements, let's join Russ Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk a little bit about preparing personal financial statements. Personal financial statements are prepared for individuals either to formally organize and plan their financial affairs in general, or for specific purposes, such as obtaining credit, income tax planning, retirement planning, gift and estate planning, or public disclosure of their financial affairs, depending on what kind of a position they're running for. So to start with, can you give us a little background and overview of the guidance for personal financial statements?

Mr. Madray

Sure. And, this is an area that has a kind of an interesting history to it, if you will, but like you said those that use personal financial statements are doing so and relying on them to determine whether to make a loan, grant credit, assessing financial activities of an individual, or financial affairs of public officials or candidates for office, things like that. When we talk about personal financial statements that would include the financial statements of an individual, certainly, but it could also be a group of related individuals, such as two spouses or an entire family even is still considered to be personal financial statements. I mentioned the history, prior to 1982 historical cost was the primary basis of measurement for use in personal financial statements.

But about that time with the increasing use of personal financial statements for a variety of purposes, as you mentioned earlier, there was a need, within the profession to, reassess the whole approach to, personal

financial statements, in light of those purposes, that personal financial statements were being, were being used for, so as a result, in 1982, the AICPA, issued statement of position or SOP 82-1, which is called, *Accounting and Financial Reporting for Personal Financial Statements*. Again, keeping in mind that back in those days, the AICPA did issue accounting guidance. It was in the form of statements of position later as with all, existing accounting guidance and other SOPs and otherwise, this SOP was codified in the accounting standards, codification specifically in Topic 274.

So the primary guidance for personal financial statements is now found in Accounting Standards Codification Topic 274, which is called personal financial statements. That topic provides guidance on measurement and presentation of personal financial statements. In addition, back in the 1980s and continuing up through after the Accounting Standards Codification was completed, there was an AICPA audit guide called the Personal Financial Statements guide that provided some guidance on performing and reporting on various engagements of personal financial statements, although it did venture into some accounting guidance as well, that guide was discontinued shortly after the guidance from the SOP was included in Topic 274 and much of the guidance in the guide, at least as it related to accounting issues was subsumed into Topic 274 as well.

So what ultimately did that SOP do that made the history of this kind of interesting? SOP 82-1 established the current value basis of accounting as GAAP for personal financial statements. And, of course, that's the

basis that still exists today in Topic 274 when it comes to personal financial statements. We'll talk more about estimated current value shortly, but that's where we look, so ultimately, if today, you look at Topic 274, that is going to be the be all end all for authoritative guidance related to the preparation of personal financial statements.

Ms. Grove Casey

Well, when we refer to personal financial statements, let's talk about exactly what the financial statements are. I assume they're different than a typical business balance sheet and income statement.

Mr. Madray

You're right. They do have some similarities, but they also can look very, very different than your typical business financial statement. So personal financial statements consist of first and foremost, a statement of financial condition, which is, I guess, kind of the equivalent of the balance sheet. That is the basic personal financial statement. It presents the estimated current values of the assets, the estimated current amounts of the liabilities, estimated income taxes on the differences between those estimated current values of assets and estimated current amounts of liabilities and their tax basis, ultimately net worth at a specified date. The term net worth is used in this statement to designate that difference between the total assets and total liabilities as opposed to any other term like equity or anything of that nature, net worth is the stipulated term to be used.

There is an activity type statement, the equivalent of an income statement, called a statement of changes in net worth. But this is actually an optional statement. It's not required to complete a set. A set of personal financial statements can be considered complete when it consists of only the statement of financial condition along with the necessary disclosures. But the statement of changes in net worth presents the major sources of increases in and decreases in the overall net worth. It's going to present the major sources of increases in net worth like income, increases in estimated current values of assets, decreases in estimated current amounts of liabilities, and so on. And then it would also present the major sources of decreases in net worth, which would be expenses, and decreases in estimated current values of assets, and so on. The presentation of this statement, as I said, is optional so that if it is not included, it's still considered a complete presentation. And that has implications for the reporting accountant. The audit,

review, compilation of the statements how they would refer to this, and the complete set. Finally, as is the case, even with businesses, comparative financial statements are not required. But in the case of personal financial statements again, it is preferable, because you get, again, typically a more informative presentation when you have two or more periods presented together, rather than having financial statements, specifically a statement of financial condition for just the one period or that one date. So a statement of financial condition, always, the statement of changes in net worth optional may or may not be included. And then, there are required disclosures that we'll talk about before we finish up that would make for a complete presentation of those financial statements.

Ms. Grove Casey

Well, what about the basis of presentation? Do personal financial statements use the accrual basis?

Mr. Madray

In a short answer, yes. Assets and liabilities, and those changes in those should be recognized on an accrual basis in personal financial statements. Again, we're assuming personal financial statements prepared in accordance with generally accepted accounting principles. It certainly is possible to prepare personal financial statements on an other comprehensive basis, like a cash basis, but GAAP for personal financial statements is the accrual basis. Taking that a step further you typically see the presentation of assets and liabilities in the statement of financial condition in order of liquidity for assets, in order of maturity in terms of the liabilities, however, you do not have and should not have a classified presentation. In other words, assets and liabilities will not be, should not be, classified as current or non-current in personal financial statements, because that underlies a concept of working capital that is relevant to a business enterprise, but not relevant or appropriate in personal financial statements.

So accrual basis, yes. Order of liquidity, order of maturity, yes; classified current, non-current, no; we don't do that. Also, there's some issues that come into play in this kind of the way we measure things or account for these things. If personal financial statements are prepared for like one individual of a group of joint owners of assets, then the statements would include only that person's interest as a beneficial owner, as it's determined under the proper laws. Assuming it's, real estate, for example, if the property

is held in joint tenancy as community property or through some similar, joint ownership arrangement, the legal status of the separate equities or ownership interest of the parties might not be evident. In that case an individual might have to get legal advice to determine whether an interest in the property needs to be included among their assets. And if so, what the proper allocation of that ownership interest would be under applicable state laws. Business interests create some issues and questions. Business interest that constitutes a large part of the person's total assets should be some shown separately from other types of investments. The estimated current value of an investment in a separate entity, like a closely held corporation or partnership or something like that should be shown as one amount as an investment assuming the entity is marketable as a going concern. Assets and liabilities with a separate entity should not be combined with similar personal items.

So we would show those. It's important in personal financial statements to indicate what are the actual personal assets in this case, especially if you had a sole proprietorship that can get very murky in terms of how we keep that separate, but it ultimately, should be separated and shown as one line item, as opposed to commingling those assets and liabilities with the personal assets and liabilities. Then you might have a limited business activity that's not conducted in a separate business entity, maybe own a piece of real estate that has a mortgage on it, but it's shown or you used it as a rental property, then that might be shown as separate amounts as opposed to one business activity. So lots of judgment involved and the best way to show these kinds of items in personal financial statements, in an instance like that with the real estate rental property is a matter of, where are the funds going to come from to satisfy the major part of that mortgage liability, if it's from sources unrelated to the real estate, that rental income, then showing separately probably makes more sense. Whereas, if it's totally self supporting, then maybe, one line presentation might be more appropriate for that kind of thing. So lots of little issues like that, that we are going to come across in personal financial statements that we typically would not have to deal with or certainly not those specific types of things that we would deal with in business financial statements.

Ms. Grove Casey

You mentioned estimated current value. Can you discuss what that measurement basis is?

Mr. Madray

Sure. And, that is the kind of the key difference if you will between personal financial statements [and business financial statements]. Of course, there's lots of differences, but, certainly from a measurement basis standpoint it is different. Keep in mind the primary focus of personal financial statements is on the individual's assets and liabilities. You know, the primary users of those personal financial statements normally would consider current value to be more relevant for their decision making than historical cost information. That's how they arrived at the conclusion to use estimated current value. Now in the codification's master glossary, there is a definition of estimated current value, and we have it on this next slide, where it defines estimated current value for assets as the amount at which the item could be exchanged between a buyer and seller, each of whom is well informed and willing, and neither of whom is compelled to buy or sell. And likewise, liabilities are measured at their estimated current amounts at the date of the financial statements again, using the accrual basis of accounting. It bears mentioning here that the concept of estimated current value or estimated current amount in the case of personal financial statements is very different from historical cost, certainly, but also different than the concept of fair value as that's defined in Topic 820. Sometimes those terms are confused and you might be inclined to measure personal assets and liabilities at fair values in that Topic 820 concept rather than the estimated current value that is required for personal financial statements. The main difference is fair value as defined in Topic 820 is an exit price concept based on an orderly transaction between market participants. In the case of personal financial statements, we're looking at the amount at which the item could be exchanged between a buyer and seller. Each of whom is well informed and willing, and neither of whom is compelled to buy or sell, so while there might be some similarities, it is a different concept. And certainly, the use of estimated current value in personal financial statements, since it is not technically fair value, would not carry with it all of the fair value disclosure requirements that would be the case where you are using actual fair value from Topic 820. Also it's important to note that the methods that we use to estimate the current values of the assets and the estimated current amounts of the liabilities need to be followed consistently from period to period, unless there's some change in facts and circumstances that would dictate a change to a different method.

If we do change the method that we use to estimate those current values then that's going to fall under the guidance and topic of accounting change or error correction along with its required disclosures. Topic 274, again, with its origin being in the old SOP 82-1 recognizes that, the estimated current values of some assets can be difficult to determine and the cost of obtaining those estimated current values may ultimately exceed the benefits of getting even more accurate estimates of those values. So there is some discussion in Topic 274 of some approaches, none of which is dictated and, there's not like an order of preference but it does discuss things like recent transactions involving similar assets and liabilities and in similar circumstances could be a satisfactory approach for determining estimated current values or estimated current amounts of liabilities.

If we don't have recent sales information available then we might look to other methods maybe capitalizing past earnings or capitalizing prospective earnings. We might look at liquidation values. We might look at historical lost as a starting point and then adjusting that using some, we may need to look to professional appraisals. We may need to look at discounted future cash receipts and payments. But again, any, or all of those methods is acceptable. It is important, again, that we are consistent in the use of our methods. And we'll talk about some required disclosures shortly. We also will need to disclose the methods we use for our major types of assets and liabilities in terms of estimating those current values and current amounts. If we're determining estimated current values of certain assets, again, these could be very specific things for which, discounted cash flows or historical costs, and other things may not be appropriate like works of art or jewelry, or maybe restricted securities or real estate. Again, those will be where we really may need to bring in a specialist to get an accurate or most accurate estimate of current value of those kinds of those assets. Again, once we use a method, apply it consistently, period to period. And then we'll talk about how we go about disclosing in those methods shortly.

Ms. Grove Casey

Well, let's look at the estimated current value basis a bit further. Can you describe how some common types of assets and liabilities would be measured?

Mr. Madray

Sure. And again, there are some methods more commonly used than others with respect to certain

kinds of assets. So we could go through a few of those for example, receivables, personal financial statements would present receivables typically at the discounted amount of cash that the person expects to collect. Again, that would require a choice of a discount rate which would require some judgment, but typically receivables would be valued in that way. Some type of discounted cash flow approach for investments in marketable securities. If there are market quotations available then we typically would go with those quoted market prices estimated current values for securities traded on exchanges. Typically, it'd be the closing price of the securities on the date of the financial statements if they're actually traded on that date. If there were no trades on that date, but there were some published bid and ask prices, then we could make an estimate of the value of the securities as being somewhere within the range of those bid and ask prices. We have securities that are traded at an over the counter market, again, we might look to other sources for bid and ask prices, other financial reporting services, or maybe going to an individual broker for help in valuing those particular securities. In those situations, an average of the bid prices, average of the bid and ask prices, an average of prices of selection from broker/dealers that are quoting those securities might be appropriate methods for those types of securities. It is important to keep in mind that if an individual holds a large block of equity in a company, then there may need to be some adjustment to those quoted values. A large block of stock might not be saleable at the price where a small number of shares might have been recently sold or quoted.

On the other hand, large non-controlling interest could also be difficult to sell despite some of isolated sales of a small number of shares. Then it goes the other direction too, as a controlling interest may be proportionately more valuable than a non-controlling interest. So we need to consider all of these factors and these may require some adjustment to quoted prices on smaller numbers of shares. Certainly, if there's restrictions on the transfer of the security, that's also going to require the need for some type of adjustment on those recent market prices in determining that overall estimated current value.

We might have options, same kind of thing. We're going to look for quoted prices if those are available. If not, we might look at other factors like the exercise price, length of the option periods, things of that nature. Life insurance is a common one. The estimated current value of an investment in life insurance would typically

be the cash value of the policy, less any loans that are outstanding against that cash value. We also typically would disclose the face amount of the life insurance of the individuals who own that. Investments in closely held businesses—we touched on this earlier in cases where, like I said earlier, we have an investment in an ownership interest in a corporation or a partnership or something of that nature. That investment in the business enterprise needs to be presented or should be presented in the statement of financial condition, and that net investment should be at its estimated current value at the date of the financial statements. If this is a closely held business, there's likely no established, ready market for that investment. So we're going to have to use judgment again in determining the estimated current value of that investment as the case in all of these situations. There's no one generally accepted procedure that's appropriate for determining an estimated current value. But we might look at things like earnings multiples. We might look at liquidation value. We might look at appraisals. We might look at discounted cash flow. We might start with the book value of the person's ownership interest, and adjust it from there. So, any of these things could be used, might be useful depending on the situation.

Also, sometimes especially in smaller businesses, the owner of an interest may have entered into a buy-sell agreement. If that exists, it could be considered, but that is not the be all end all value of that interest. Ultimately like with all these things, the objective in valuing the business would be to try to approximate the amount that the investment could be exchanged between a buyer and seller each of whom is well informed and willing, and neither of whom is compelled to buy or sell. Real estate is a common asset in personal financial statements. Again, should be presented at estimated current value there, again, looking at sales of similar property and similar circumstances might involve discounted cash flows, especially obviously, if it were some type of income-producing property, maybe appraisals, a professional real estate appraisal, maybe appraisal that was used to obtain the financing if it's still recent enough. Maybe we used assessed value for property taxes as at least a starting point, although, that may not be related directly to the current market value of the property.

Ms. Grove Casey

Oh, particularly not in today's market.

Mr. Madray

Oh, yes. Sorry. Very good point. One other one intangible assets—sometimes individuals own or have rights and maybe a royalty agreement. Again, typically you know, discounted cash flows might be the best approach there. If no other information is available, maybe the cost, if the intangible asset was purchased and the purchase was recent enough, that may be another approach to use there. But those are just some of the common methods, models, approaches used for various types of assets we normally see in personal financial statements. Again, no one is right, no one is wrong, but some things to at least look at and choose from.

Ms. Grove Casey

Well, what about future interests? So, you know, a lot of people have, well, not so many with the pensions any longer, but for many people, social security makes up a big part of their financial planning for retirement. Do we show those kinds of things? Would those be presented as assets in personal financial statements?

Mr. Madray

The answer is, it depends. These future rights are future interests. If they are nonforfeitable and they have the characteristics that you see on this slide, then they are presented as assets. Number one, the rights have to be for fixed or determinable amounts. The rights cannot be contingent on the holder's life expectancy or the occurrence of some event like disability or death, and the rights must not require any future performance of service by the holder. So what kinds of things might typically be characteristics? Again, if there actually is still pension interest out there, as long as you could look at the guaranteed minimum amounts of pension plans, vested interests in pensions or profit sharing plans, deferred compensation contracts might meet those requirements, annuities, fixed amounts of alimony for a definite future period, for example, would meet that requirement.

But again, it's looking at those three characteristics. That's what has to exist in order for that type of future interest to be shown as an asset in the personal financial statements. So you mentioned social security benefits. If you think through that, social security benefits are based on future life expectancy of an individual, and therefore, would not qualify as an asset under those characteristics. One of the criteria is the rights must not

be contingent on the individual's life expectancy or occurrence of a particular event. Social security benefits are contingent on individual's life expectancy, and therefore, would not qualify as an asset in the personal financial statements. Now we talked about several different types of assets.

Let's mention a few things on the liability side as well, common approaches used, and you tend to have most of your liabilities are going to fall into that category of discounted future cash flows. Payables, other types of liabilities, where there are, definite future cash payments associated with those, then the discounted future cash flows would be the most obvious choice there to value those liabilities. In that case, the discount rate should be the rate that's implicit in the transaction unless the debtor could discharge the debt currently at a lower amount, in that case, you could present the debt at that lower amount. A flip side of your question a moment ago about the future of interest. What if you're on the other side of that? You have a noncancelable commitment. If you take a look at this slide, you're going to see some very similar characteristics. If we have some type of noncancelable commitment to pay future sums and they have all three of these characteristics, then we would show those things as a liability on the personal financial statement. So commitments need to be for fixed or determinable amounts. The commitments must not be contingent on the other person's life expectancy or occurrence of some particular event like disability or death, and the commitments must not require any future performance of service by others. So, for example if it has an obligation to pay alimony and is for a fixed or determinable amount, it's for a fixed period and doesn't require any future performance, then that would be recorded as a liability. On the other hand, that alimony obligation that's based on payment until death of the former spouse or subsequent marriage of the former spouse would not be shown as a liability because it is dependent on life expectancy or occurrence of another future event. Just one other thing to mention in the area of measuring liabilities, income taxes payable. The liability for income taxes payable needs to include any unpaid income taxes for any completed tax years, as well as the elapsed portion of the current tax year, as of the date of the financial statements. That estimate should be based on the relationship of taxable income earned to date to the total estimated taxable income for the year net of any taxes that have been withheld or paid, with estimated, payments throughout the year.

So that's one that we want to remember to include as a typical liability as well, but on the liability side, typically not as many different approaches or methods to come up with the estimated current amount as we do on the asset side, because there's so many different possibilities over on that side.

Ms. Grove Casey

Well, I seem to recall that there is some type of special tax presentation for personal financial statement. Could you discuss what that entails?

Mr. Madray

Certainly, and I just mentioned income taxes payable, but there's something unique on the personal financial statements that is required. It's a provision for the estimated income taxes on the differences between the estimated current values of the assets and the estimated current amounts of the liabilities and their tax bases including consideration of negative tax basis of any tax shelters, if those exist. This provision that we're talking about is computed as if the estimated current values of all the assets had been realized and the estimated current amounts of all the liabilities had been liquidated on the statement date using the applicable income tax laws and regulations taking into account recapture provisions available, carryovers, and that kind of thing. And then, it's presented between liabilities and net worth on the statement of financial condition.

So it's important to understand this is like another element on the statement. This is not a liability and sometimes folks mistake this for the income tax liability. That's not what this is. This is a hypothetical on what the tax implication would be if all these assets were liquidated, all the liabilities were liquidated. What would the tax implications be in that case? And it's presented separately. It's not part of liabilities. It's presented separately between liabilities and net worth on that statement of financial condition. Because you know, for a variety of reasons, one, it is so hypothetical and so much judgment is required to come up with this provision. It's not unusual to see this omitted, but it's important to remember if it's omitted, that is a GAAP departure in those personal financial statements and would need to be noted as such in any kind of report, compilation, review report, for example, on those statements. There's some disclosures related to that, of course, as well. That's something that, again, kind of sets personal financial statements apart from other business entity type financial statements where we would not normally see something like that in the balance sheet.

Ms. Grove Casey

Well, there wouldn't be a set of financial statements without disclosures. So what about the disclosures for personal financial statements? Are there specific requirements there?

Mr. Madray

There are specific requirements and then also a whole bunch that we needed to keep in mind.

So let's look at the next slide. These are the ones that are specifically required under Topic 274. So you see here description of the individuals who may make up the reporting entity, description of the nature of joint ownership for assets that are presented in the financial statements. If that is in fact applicable, disclosure of the names of companies or industries if we have investment portfolios that are concentrated in just one or a few companies or industries, specific disclosure related to investments in closely held businesses, situations where that ownership is not available to the general public, that would include things like the name of that closely held business, the client's ownership percentage in that business, the nature of that business, the accounting basis used to prepare the financial statements.

We also have to include in the disclosures in the personal financial statements, summarized financial information about the assets, liabilities and results of operations. That's a common deficiency that will we see in personal financial statements is not disclosing that information in the notes. And that typically requires a little summarized balance sheet, so to speak and a little, at least some mention of some major elements of the income statement of that closely held business, also disclosure of any significant loss contingencies related to that closely held business. Other types of disclosure requirements include description of any intangible assets that the individual owns, as well as the estimated useful lives disclosure of the face amount of any life insurance that exists. Descriptions of any of those future interests that are not presented as an asset.

So here's where you could have some description of the expected social security benefits, and that kind of thing. Disclosure of specific tax information, including description of any unused operating loss or capital loss carry forward disclosure of any other unused deductions and credits along with expiration periods disclosure by individual items or by categories of differences between the reported values of the assets

and liabilities and their tax bases. That's the underlying kind of schedule it typically is presented as a schedule in the notes of that provision that's shown that we talked about just a moment ago, provision for the tax on the difference between the estimated values of the assets, estimated current amounts of the liabilities. Other things include disclosure of maturities, interest rates, other information related to receivables and debt.

And then, finally, description of any noncancelable commitments that are not reported as the future interest, again, where it does not meet the characteristics to be shown as a liability in the personal financial statements. So again, my example if there were an alimony arrangement where alimony is paid through the death or subsequent marriage of the former spouse, that would not qualify for reporting as a liability, but that is something that would be disclosed in the notes description of that arrangement and so on. So a number of things that that are enumerated in Topic 274 in terms of things that are required to be disclosed. In addition, other things, as I said, there's the specifics, then you have to keep in mind a lot of other things that may also be necessary.

Although not directed specifically at personal financial statements, for example, contingencies; an individual can have contingencies that may need to be evaluated. Certain contingencies, litigation, for example, probably going to have related party transactions, very well could have subsequent events. So things like that need to be considered as well. And if they exist, they need to be included in those notes just as they would for businesses or any other type of entity. So personal financial statements, all in all, are a unique animal as we have seen and discussed. Hope this is helpful for our folks to kind of wrap their brain around some of those issues, so we can avoid some of those common mistakes that are made when preparing these statements.

SUPPLEMENTAL MATERIALS

Personal Financial Statements

by J. Russell Madray, CPA, CGMA

Financial Statements

Personal financial statements consist of—

- *A statement of financial condition.* This is the basic personal financial statement. It presents the estimated current values of assets, the estimated current amounts of liabilities, estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases, and net worth at a specified date. The term net worth should be used in the statement to designate the difference between total assets and total liabilities, after deducting estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases.
- *A statement of changes in net worth.* This statement presents the major sources of increases and decreases in net worth. It should present the major sources of increases in net worth: income, increases in the estimated current values of assets, decreases in the estimated current amounts of liabilities, and decreases in estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases. It should present the major sources of decreases in net worth: expenses, decreases in the estimated current values of assets, increases in the estimated current amounts of liabilities, and increases in estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases. One statement combining income and other changes is desirable because of the mix of business and personal items in personal financial statements. The presentation of a statement of changes in net worth is optional.
- *Comparative financial statements.* The presentation of comparative financial statements of the current period and one or more prior periods may sometimes be desirable. Such a presentation is more informative than the presentation of financial statements for only one period. The presentation of comparative financial statements is optional.

The Methods of Presentation

Assets and liabilities and changes in them should be recognized on the accrual basis, not on the cash basis. The most useful and readily understood presentation of assets and liabilities in personal financial statements is by order of liquidity and maturity. Assets and liabilities are not classified as current and noncurrent since the concept of working capital applied to business enterprises is not appropriate for personal financial statements.

If personal financial statements are prepared for one of a group of joint owners of assets, the statements should include only the person's interest as a beneficial owner, as determined under the property laws of the state having jurisdiction. If property is held in joint tenancy, as community property, or through a similar joint ownership arrangement, the legal status of the separate equities of the parties may not be evident. In that case, the person may require legal advice to determine whether an interest in the property should be included among the person's assets and, if so, the proper allocation of the equity in the property under the applicable state laws.

Business interests that constitute a large part of a person's total assets should be shown separately from other investments. The estimated current value of an investment in a separate entity, such as a closely held corporation, a partnership, or a sole proprietorship, should be shown in one amount as an investment if the entity is marketable as a going concern. Assets and liabilities of the separate entity should not be combined with similar personal items.

The estimated current values of assets and the estimated current amounts of liabilities of limited business activities not conducted in a separate business entity, such as an investment in real estate and a related mortgage, should be presented as separate amounts, particularly if a large portion of the liabilities may be satisfied with funds from sources unrelated to the investment.

Estimated Current Value

Personal financial statements should present assets at their estimated current values and liabilities at their estimated current amounts. The estimated current value

of an asset in personal financial statements is the amount at which the item could be exchanged between a buyer and seller, each of whom is well informed and willing, and neither of whom is compelled to buy or sell. Costs of disposal, such as commissions, if material, should be considered in determining estimated current values. FASB ASC 274 recognizes that the estimated current values of some assets may be difficult to determine and the cost of obtaining estimated current values of some assets directly may exceed the benefits of doing so; therefore, FASB ASC 274 recommends that judgment be exercised in determining estimated current values.

Recent transactions involving similar assets and liabilities in similar circumstances ordinarily provide a satisfactory basis for determining the estimated current value of an asset and the estimated current amount of a liability. If recent sales information is unavailable, other methods that may be used include the capitalization of past or prospective earnings, the use of liquidation values, the adjustment of historical cost based on changes in a specific price index, the use of appraisals, or the use of the discounted amounts of projected cash receipts and payments.

In determining the estimated current values of some assets (for example, works of art, jewelry, restricted securities, investments in closely held businesses, and real estate), the individual may need to consult a specialist.

The methods used to determine the estimated current values of assets and the estimated current amounts of liabilities should be followed consistently from period to period unless the facts and circumstances dictate a change to different methods.

Estimated Current Values of Assets

Receivables

Personal financial statements should present receivables at the discounted amounts of cash the person estimates will be collected, using appropriate interest rates at the date of the financial statements.

Marketable Securities

Marketable securities include both debt and equity securities for which market quotations are available. The estimated current values of such securities are their quoted market prices. The estimated current values of securities traded on securities exchanges are the closing

prices of the securities on the date of the financial statements (valuation date) if the securities were traded on that date. If the securities were not traded on that date but published bid and asked prices are available, the estimated current values of the securities should be within the range of those prices.

Investments in Closely Held Businesses

FASB ASC 274 recognizes that the estimated current values of investments in closely held businesses usually are difficult to determine. The problems relate to investments in closely held businesses in any form, including sole proprietorships, general and limited partnerships, and corporations. As previously stated, only the net investment in a business enterprise (not its assets and liabilities) should be presented in the statement of financial condition. The net investment should be presented at its estimated current value at the date of the financial statement. Since there is usually no established ready market for such an investment, judgment should be exercised in determining the estimated current value of the investment.

There is no one generally accepted procedure for determining the estimated current value of an investment in a closely held business. Several procedures or combinations of procedures may be used to determine the estimated current value of a closely held business, including a multiple of earnings, liquidation value, reproduction value, appraisals, discounted amounts of projected cash receipts and payments, or adjustments of book value or cost of the person's share of the equity of the business. The owner of an interest in a closely held business may have entered into a buy-sell agreement that specifies the amount (or the basis of determining the amount) to be received in the event of withdrawal, retirement, or sale. If such an agreement exists, it should be considered, but it does not necessarily determine estimated current value. Whatever procedure is used, the objective should be to approximate the amount at which the investment could be exchanged between a buyer and a seller, each of whom is well informed and willing, and neither of whom is compelled to buy or sell.

OBSERVATION: The book value or cost of a person's share of the equity of a business adjusted for appraisals of specific assets, such as real estate or equipment, is sometimes used as the estimated current value.

Real Estate (Including Leaseholds)

Investments in real estate (including leaseholds) should be presented in personal financial statements at their estimated current values. Information that may be used in determining their estimated current values includes—

- Sales of similar property in similar circumstances.
- The discounted amounts of projected cash receipts and payments relating to the property or the net realizable value of the property, based on planned courses of action, including leaseholds whose current rental value exceeds the rent in the lease.
- Appraisals based on estimates of selling prices and selling costs obtained from independent real estate agents or brokers familiar with similar properties in similar locations.
- Appraisals used to obtain financing.
- Assessed value for property taxes, including consideration of the basis for such assessments and their relationship to market values in the area.

Intangible Assets

Intangible assets should be presented at the discounted amounts of projected cash receipts and payments arising from the planned use or sale of the assets if both the amounts and timing can be reasonably estimated. The cost of a purchased intangible should be used if no other information is available.

Future Interests and Similar Assets

Nonforfeitable rights to receive future sums that have all the following characteristics should be presented as assets at their discounted amounts:

- The rights are for fixed or determinable amounts.
- The rights are not contingent on the holder's life expectancy or the occurrence of a particular event, such as disability or death.
- The rights do not require future performance of service by the holder.

Note, that TIS Section 1600.03, "Social Security Benefits—Personal Financial Statements," states that social security benefits to be received based on the

future life expectancy of an individual do not qualify as an asset in personal financial statements. As discussed above, FASB ASC 274 indicates that nonforfeitable rights to receive future sums must meet certain criteria to be accounted for as assets. One of these criteria is that the rights must not be contingent on the individual's life expectancy or the occurrence of a particular event, such as disability or death. In this situation, because the social security benefits are contingent on the individual's life expectancy, they do not qualify as a recognizable asset for the personal financial statements.

Estimated Current Amounts of Liabilities

Payables and Other Liabilities

Personal financial statements should present payables and other liabilities at the discounted amounts of cash to be paid. The discount rate should be the rate implicit in the transaction in which the debt was incurred. If, however, the debtor is able to discharge the debt currently at a lower amount, the debt should be presented at the lower amount.

Noncancellable Commitments

Noncancellable commitments to pay future sums that have all the following characteristics should be presented as liabilities at their discounted amounts:

- The commitments are for fixed or determinable amounts.
- The commitments are not contingent on others' life expectancies or the occurrence of a particular event, such as disability or death.
- The commitments do not require future performance of service by others.

Noncancellable commitments that may have those characteristics include fixed amounts of alimony for a definite future period and charitable pledges.

Income Taxes Payable

The liability for income taxes payable should include unpaid income taxes for completed tax years and an estimated amount for income taxes accrued for the elapsed portion of the current tax year to the date of the financial statements. That estimate should be based on the relationship of taxable income earned to date to total

estimated taxable income for the year, net of taxes withheld or paid with estimated income tax returns.

Estimated Income Taxes on the Differences

A provision should be made for estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases, including consideration of negative tax bases of tax shelters, if any. The provision should be computed as if the estimated current values of all assets had been realized and the estimated current amounts of all liabilities had been liquidated on the statement date, using applicable income tax laws and regulations, considering recapture provisions and available carryovers. The estimated income taxes should be presented between liabilities and net worth in the statement of financial condition. The methods and assumptions used to compute the estimated income taxes should be fully disclosed.

Disclosures

Some of the disclosures required by FASB ASC 274 include the following:

- Description of the individuals who make up the reporting entity.
- Description of the nature of joint ownership for assets presented in the financial statements (if applicable).
- Disclosure of the names of the companies or industries if investment portfolios are concentrated in one or a few companies or industries.
- Disclosure of the following for investments in a closely held business, i.e., ownership not available to the general public:
 - The name of the closely held business
 - The client's ownership percentage in the business
 - The nature of the business
 - The accounting basis used to prepare the financial statements
- Description of noncancelable commitments not reported as liabilities.

In addition, consideration should be given to whether other disclosures are necessary for the personal financial statements to satisfy the standard for adequate disclosure. For example, contingencies or related party transactions may require disclosure.

Identification of Individuals and Estimated Current Values

According to FASB ASC 274, personal financial statements should clearly indicate the individuals covered by the financial statements and the fact that the assets are presented at their estimated current values and that the liabilities are presented at their estimated current amounts. Normally, this is included at the beginning of the summary of significant accounting policies. If the financial statements are compiled with substantially all disclosures omitted, the compilation report should be modified to disclose this fact. The following is an example of this disclosure:

NOTE A. The accompanying financial statements include the assets and liabilities of Mr. and Mrs. John Doe. Assets are stated at their estimated current values, and liabilities at their estimated current amounts.

Summary of Significant Accounting Policies

The first note (or disclosure) presented after the financial statements should be a summary of significant accounting policies. As noted in FASB ASC 235, *Notes to the Financial Statements*, the following topics should be considered in determining what accounting principles and methods to describe in the summary:

- A selection from existing acceptable alternatives
- Principles and methods peculiar to the industry in which the reporting enterprise operates, even if such principles and methods are predominantly followed in that industry
- Unusual or innovative applications of generally accepted accounting principles (GAAP) (and, as applicable, of principles and methods peculiar to the industry in which the reporting enterprise operates)

For most personal financial statements, only descriptions related to the first category (existing acceptable alternatives) will be presented in the

summary of significant accounting policies. For example, FASB ASC 274 identifies several methods that can be used to determine the current value of investments in real estate.

Methods Used to Determine Estimated Current Values

According to FASB ASC 274, the financial statements should disclose the methods used in determining the estimated current values of major assets and the estimated current amounts of major liabilities or major categories of assets and liabilities, since several methods are available, and changes in methods from one period to the next. The following are examples of this disclosure:

NOTE B. Jane Doe owns options to acquire 4,000 shares of stock of Dot Com Corp. at an option price of \$5 per share. The option expires on June 30, 2019. The estimated current value is its published selling price.

NOTE C. The investment in Chandler Associates is an 8% interest in a real estate limited partnership. The estimated current value is determined by the projected annual cash receipts and payments capitalized at a 12% rate.

NOTE D. The estimated current value of the residence is its purchase price plus the cost of improvements. The residence was purchased in December 2015, and improvements were made in 2016 and 2017.

NOTE E. The estimated current values of personal effects and jewelry are the appraised values of those assets, determined by an independent appraiser for insurance purposes.

Investment Portfolio

According to FASB ASC 274, if the individual's investment portfolio is material in relation to his or her other assets and is concentrated in one or a few companies or industries, the names of the companies or industries and the estimated current values of the securities should be disclosed. The following is an example of this disclosure:

NOTE F. The estimated current values of marketable securities are either (a) their quoted closing prices or (b) for securities not traded on the financial statement date,

amounts that fall within the range of quoted bid and asked prices. Marketable securities consist of the following:

	<u>December 31, 2018</u>		<u>December 31, 2017</u>	
	Number of shared or bonds	Estimated current values	Number of shares or bonds	Estimated current values
<u>Stocks</u>				
Miller Jewels, Inc.	1,500	\$ 98,813		
Windsor Motors, Ltd.	800	11,000	600	\$ 4,750
McAlister Sisters, Inc.	400	13,875	200	5,200
Quinn Rug Co.			1,200	96,000
Carmichael Paint Company	300	9,750	100	2,875
Reese, Inc.	200	<u>20,337</u>	300	<u>25,075</u>
		153,775		133,900
<u>Bonds</u>				
Porta-John, Ltd. (12% due 7/1/19)	5	5,225	5	5,100
United Colors, Inc. (7% due 11/15/19)	2	<u>1,500</u>	2	<u>1,700</u>
		<u>6,725</u>		<u>6,800</u>
		<u>\$160,500</u>		<u>\$140,700</u>

Investment in Closely-Held Business

If the individual has a material investment in a closely held business, at least the following should be disclosed, according to FASB ASC 274:

- The name of the company and the person's percentage of ownership
- The nature of the business
- Summarized financial information about assets, liabilities, and results of operations for the most recent year based on the financial statements of the business, including information about the basis of presentation (for example, generally accepted accounting principles, income tax basis, or cash basis) and any significant loss contingencies

The following is an example of this disclosure:

NOTE G. John Doe owns 50% of the common stock of Connor Company, Inc., a retail mail order business. The estimated current value of the investment is determined by the provisions of a shareholders' agreement, which restricts the sale of the stock and, under certain conditions, requires the company to repurchase the stock based on a price equal to the book value of the net assets plus an agreed amount for goodwill. At December 31, 2018, the agreed amount for goodwill was \$112,500, and at December 31, 2017, it was \$100,000.

A condensed balance sheet of Connor Company, Inc., prepared in conformity with generally accepted accounting principles, is summarized below:

	December 31,	
	2018	2017
Current assets	\$3,147,000	\$2,975,000
Plant, property, and equipment – net	165,000	145,000
Other assets	<u>120,000</u>	<u>110,000</u>
Total assets	3,432,000	3,230,000
Current liabilities	2,157,000	2,030,000
Long-term liabilities	<u>400,000</u>	<u>450,000</u>
Total Liabilities	<u>2,557,000</u>	<u>2,480,000</u>
Equity	<u>875,000</u>	<u>750,000</u>

The sales and net income for 2018 were \$10,500,000 and \$125,000 and for 2017 were \$9,700,000 and \$80,000.

Life Insurance

According to FASB ASC 274, the financial statements should disclose the face amount of life insurance the individuals own. The following is an example of this disclosure:

NOTE H. At December 31, 2018 and 2017, John Doe owned a \$300,000 whole life insurance policy.

Nonforfeitable Rights

Nonforfeitable rights that do not have the characteristics discussed earlier, for example, pensions based on life expectancy, should be disclosed. The following is an example of this disclosure:

NOTE I. Jane Doe is the beneficiary of a remainder interest in a testamentary trust under the will of the late Joseph Winstead. The amount included in the accompanying statements is her remainder interest in the estimated current value of the trust assets, discounted at 10%.

Receivables and Debt

Maturities, interest rates, collateral, and other pertinent details relating to receivables and debt should be disclosed. The following is an example of this disclosure:

NOTE J. The mortgage (collateralized by the residence) is payable in monthly installments of \$815 a month, including interest at 10% a year through 20Y9.

Tax Information

The following tax information should be disclosed:

- The methods and assumptions used to compute the estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases and a statement that the provision will probably differ from the amounts of income taxes that might eventually be paid because those amounts are determined by the timing and the method of disposal, realization, or liquidation and the tax laws and regulations in effect at the time of disposal, realization, or liquidation
- Unused operating loss and capital loss carryforwards
- Other unused deductions and credits, with their expiration periods, if applicable
- The differences between the estimated current values of major assets and the estimated current amounts of major liabilities or categories of assets and liabilities and their tax bases

The following is an example of this disclosure:

NOTE K. The estimated current amounts of liabilities at December 31, 2018, and December 31, 2017, equaled their tax bases. Estimated income taxes have been provided on the excess of the estimated current values of assets over their tax bases as if the estimated current values of the assets had been realized on the statement date, using applicable tax laws and regulations. The provision will probably differ from the amounts of income taxes that eventually might be paid because those amounts are determined by the timing and the method of disposal or realization and the tax laws and regulations in effect at the time of disposal or realization.

The estimated current values of assets exceeded their tax bases by \$850,000 at December 31, 2018, and by \$770,300 at December 31, 2017. The excess of estimated current values of major assets over their tax bases are:

	December 31,	
	2018	2017
Investment in Connor Company, Inc.	\$430,500	\$355,500
Vested interest in deferred profit sharing plan	111,400	98,900
Investment in marketable securities	104,100	100,000
Remainder interest in testamentary trust	97,000	53,900

Other Disclosures

Other disclosures required by FASB ASC 274 that are generally considered necessary in personal financial statements include the following:

- If assets held jointly by the person and by others are included in the statements, the nature of the joint ownership
- Descriptions of intangible assets and their estimated useful lives
- Noncancellable commitments that do not have the characteristics discussed earlier, for example, operating leases

In addition, consideration should be given to whether other disclosures are necessary for the personal financial statements to satisfy the standard for adequate disclosure. For example, contingencies or related party transactions may require disclosure. The following is an example of this disclosure:

NOTE L. John Doe has guaranteed the payment of loans of Connor Company, Inc., under a \$500,000 line of credit. The loan balance was \$300,000 at December 31, 2018, and \$400,000 at December 31, 2017.



ASC Topic 274

Personal Financial Statements from SOP 82-1 and AICPA Audit Guide, *Personal Financial Statements Guide*

Personal Financial Statements

Statement of Financial Condition—
Estimated current values of assets and
estimated current amounts of liabilities

Statement of Changes in Net Worth—
(optional) major sources of increases
and decreases in net worth

Disclosures

Estimated current value

The amount at which the item could be exchanged between a buyer and seller, each of whom is well informed and willing, and neither of whom is compelled to buy or sell.

Common Asset and Liability Valuation

- Receivables—discounted amount expected to collect
- Investments in Marketable Securities—estimated market prices on exchange
- Options—quoted prices
- Life Insurance—cash surrender value less any loans
- Closely held businesses—many potential valuation techniques

Future Interests

- The rights are for fixed or determinable amounts.
- The rights are not contingent on the holder's life expectancy or the occurrence of a particular event, such as disability or death.
- The rights do not require future performance of service by the holder.

Noncancellable commitments

The commitments are for fixed or determinable amounts.

The commitments are not contingent on others' life expectancies or the occurrence of a particular event, such as disability or death.

The commitments do not require future performance of service by others.

Disclosures

- Description of the individuals who make up the reporting entity.
- Description of the nature of joint ownership for assets presented in the financial statements (if applicable).
- Disclosure of the names of the companies or industries if investment portfolios are concentrated in one or a few companies or industries.
- Disclosure of the following for investments in a closely held business, i.e., ownership not available to the general public:
 - The name of the closely held business
 - The client's ownership percentage in the business
 - The nature of the business
 - The accounting basis used to prepare the financial statements
 - Summarized financial information about the assets, liabilities, and results of operations
 - Significant loss contingencies
- Description of intangible assets and their estimated useful lives.
- Disclosure of the face amount of life insurance.
- Description of nonforfeitable rights not presented as an asset.
- Disclosure of the following tax information:
 - Description of unused operating loss and capital loss carryforwards.
 - Disclosure of other unused deductions and credits, with their expiration periods (if applicable).
 - Disclosure, by individual items or categories, of the differences between the reported values of assets and liabilities and tax bases.
- Disclosure of maturities, interest rates, and other relevant information for receivables and debt.
- Description of noncancelable commitments not reported as liabilities.

GROUP STUDY MATERIALS

A. Discussion Problems

1. How are personal financial statements different from other financial statements, such as those of a business enterprise?
2. What is meant by “estimated current value basis?”
3. The statement of financial condition of an individual includes an extra element, in addition to assets, liabilities, and equity. Discuss the purpose of the “tax provision.”

B. Suggested Answers to Discussion Problems

1. The most noticeable difference in personal financial statements is the basis of accounting that is used. According to FASB ASC 274, GAAP for personal financial statements is the “estimated current value basis.” Prior to the issuance of SOP 82-1 in 1982, personal financial statements were prepared using the same GAAP as that used for business enterprises. There are also key differences in the financial statements themselves: for example, the “balance sheet” is not classified; the balance sheet includes an element in addition to assets, liabilities and equity which is based on the tax effects of the differences between the assets and liabilities; and typically only one financial statement is presented.
2. FASB ASC 274 requires that personal financial statements “present their assets at estimated current values and liabilities at their estimated current amounts.” It defines the estimated current value of an asset as “the amount at which the item could be exchanged between a buyer and seller, each of whom is well informed and willing.” It defines the estimated current amount of a liability as “the discounted amount of cash to be paid.” There are a number of valuation techniques that could be used to establish estimated current values, including quoted market prices, liquidation values, appraisals, etc.
3. FASB ASC 274 requires that a provision be made for estimated income taxes on the differences between the estimated current values of the assets and liabilities and their tax bases. It is computed as if the estimated current values of all of the assets are realized and all of the liabilities are liquidated on the statement date. This provision is then presented on the balance sheet between the liabilities and the net worth. In practice, this provision is often omitted, however. If the provision is omitted, it would be treated as a GAAP departure and identified in the compilation or review report (or result in a qualified opinion in an audit).

PART 2. AUDITING

SAS 145

Deficiencies in the auditor's risk assessment procedures is a common issue identified in peer review. In 2020, AU-C §315 on understanding the entity and assessing the risks of material misstatement made up 25 percent of all matters for further consideration. While SAS 145 supersedes the existing guidance in §315, and amends other sections related to risk assessment and assessing control risk, it does not fundamentally change the key concepts underlying audit risk.

For more on the clarifications and enhancements SAS 145 makes to the guidance, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about a new SAS that's come out, and that SAS happens to be SAS 145 on risk assessment. Now we've had guidance on risk assessment for quite some time. So why did the Auditing Standards Board decide that it was important to revisit the risk assessment process and audit?

Ms. Louis

A lot of it had to do with what they were continuing to see as issues when they did the peer reviews and looking at how people were applying the existing concepts about audit risk and assessing your risk of material misstatement. And that ultimately led to about 25% of the matters that they found through peer review that had to be further considered of those related to the whole risk assessment process. And ultimately they decided then to just take a fresh look at it, to make sure that they were getting more consistency in how it is that those concepts are being applied. But also because there were changes being made internationally and looking at what's going on with PCAOB and their audit standards that we also wanted to continue convergence with the various standard setting bodies.

Ms. Grove Casey

Well, how much does this new SAS change the fundamental concepts of audit risk and assessment risk of material misstatement?

Ms. Louis

Fundamentally, it's not changing substantially the key concepts that underpin or underlie the audit risk process, that model where you have inherent risk and control risk and attaching risk. What it does do is clarify certain definitions. It enhances certain aspects and factors of things they would like you to consider as you

are going through identifying and assessing your risk in order to better drive the quality of the audits. And specifically, it's intended to make sure that you can do things like, how do I apply what I know about the entity, its environment, including internal controls as it relates to my risk assessment and how do I modernize my considerations on IT? And how do I ultimately look to identify these significant risks that might result from some of these matters that might be related to economic technological regulatory aspects of things that perhaps were always being adapted into the underpinning model.

Ms. Grove Casey

Let's talk a little bit about the effective date for this new Standard.

Ms. Louis

It's going to be effective for audits of your financial statements for periods ending on or after December 15, 2023.

Ms. Grove Casey

Well, I know there were some recent changes related to risk assessment in the international audit standards. How did this initiative impact this project?

Ms. Louis

I did mention how there were some things happening from the international audit standard point of view. And in fact, they had an international standards of audits 315 as is their section of the codification that relates to that. That was revised back in 2019, that was effective for audits of financial statements for periods beginning on or after 12/15/2021. So they're in the midst of internationally going through a strategic objective to relook at the risk assessment process, that's applied on

an international scale, but definitely some of the enhanced definitions and some of the clarifications from what was happening from that initiative did get pulled into what we're doing here in the United States as well.

Ms. Grove Casey

Would you classify this new approach as being principles based?

Ms. Louis

Absolutely. It continues to build on some of the foundational concepts related to what we have to do and conducting our audit in conformance with general accepted audit standards. The fact that you do have to identify risk at the financial statement and assertion level and other principle-based things. It is ultimately audit methodology neutral, meaning that I don't necessarily have to use a particular set of audit standards, or the same audit standards, but the practice aids, the templates and the checklists that it's audit methodology neutral instead saying each of these different audit methodologies should be applying these core principles. Ultimately, what you may find as far as the degree of impact of this new SAS on your audit methodology will depend on what did your existing audit methodology already have built into it with the different methods, tools, and techniques. In the end, we are saying that things are a matter of professional judgment and ultimately the nature, timing, and extent of procedures that are being performed are going to be based on what is sufficient and appropriate in the context of the specific engagement.

Ms. Grove Casey

If this new approach is principles based, are there still specific considerations to smaller entities embedded in the requirements?

Ms. Louis

Well, that is one of the things that as they move towards more of this principle-based role is to say that certainly we want these standards to be scalable, as we're thinking about the application of what's needed in order to meet the audit objective and get sufficient and appropriate evidence, but they decided to remove the considerations specific to smaller entities that used to be in the application materials within the codified standards. All the guidelines have been incorporated elsewhere within the standards, but what they're

recognizing is that a small organization doesn't necessarily mean low risk and a large organization doesn't necessarily mean high risk that regardless of the size of the entity, it's going to depend on the nature of your environment and the nature of your transactions and your accounting methods and other things as well, that go into the process. They wanted to ensure that that got incorporated into saying, yes, we have a scalability of risks where you need to get more persuasive evidence in some cases, and you can accept less persuasive evidence in other cases, but it's not necessarily tied to just the size of the organization by itself.

Ms. Grove Casey

Well, ultimately, an auditor is always required to maintain professional skepticism. Does this new standard enhance that guidance in any way?

Ms. Louis

It does try to provide more guidance about it. And so, you're still required, obviously, to maintain an open questioning mind as you're going about doing your audit. Some of the key provisions that are related to that would be to clarify, for example, that you have to have an appropriate understanding of the entity environment, the applicable financial reporting framework say, is it FASB GAAP, or is it income tax basis accounting? Having this understanding provides a foundation of you being able to maintain professional skepticism, the benefits of ultimately how maintaining professional skepticism should be important to the engagement team discussion as you're going through and identifying and evaluating the relative scalability of risk and putting together your detailed audit plan. They also added more emphasis on that you should be looking for, not just evidence that corroborates what reporting entity management is asserting about their financial statements, but you also should understand that there may be contradictory evidence that needs to be pursued as you have that open questioning mind. I'm not going in assuming that management is honest or dishonest. I'm not trying to prove that things are right. I'm being open-minded. It could be right. It could be wrong. We'll just follow the path that the evidence leads us on.

Ms. Grove Casey

Is there anything that has been explicitly added related to what an auditor is required to gain an understanding of in order to better identify and assess the audit risk?

Ms. Louis

The more explicit guidance does focus a lot on understanding the entity's use of IT, and also their structure, their ownership and governance, as well as their business model. As we look at the IT environment, it includes what you have as relates to the general things that support the infrastructure for your IT, but also then your specific applications. It also includes the personnel that are involved in those processes and how it is that we use IT to support the achievement of the organization's strategic objectives, but also supports functioning of their business. That focus is something that has been elaborated upon, but then also a new requirement to obtain an understanding of how inherent risk factors affect the susceptibility of a particular area to have a misstatement to it and the degree to which that could exist. And ultimately, we're looking at the preparation and fair presentation of those financial statements, but they do want you to focus more on justifying your inherent risk assessments and also specifically elaborating upon how IT affects your understanding that should affect your risk.

Ms. Grove Casey

It just sounds like an increased focus the entity's environment if that makes sense.

Ms. Louis

Absolutely.

Ms. Grove Casey

Talk about tone at the top and you're talking about it, which is their system, right? It's the processes that they have in place. Not that we didn't look at it before, but certainly an enhanced understanding of what's going on that's currently impacting the entity both externally and internally can't help but improve our assessment of risk.

So is there anything related to the required understanding of internal controls that's been clarified or enhanced besides looking at this environment, so to speak?

Ms. Louis

Right. And, exactly what you started leading into, you have the entity and its environment, right? As we think about the economic, technological, regulatory, structural strategic things that are affecting them, but then we have to have an overall understanding of the entity's system of internal control. And as we look at different components of internal controls, it's not getting rid of the COSO *Internal Control-Integrated Framework*, where you basically had your control

environment, your risk assessment, process monitoring, etc., but what they did is they tried to say, well, some of these components that are important to understand, because it's going to influence your risk assessment may only indirectly affect the preparation and fair presentation of your financials, like the tone and controls of the organization, that's going to indirectly affect your financial reporting process. Whereas you're going to have certain control activities, or even certain IT controls, like your application controls, that will directly affect the preparation and fair presentation of your financial statements. So they're keeping the same concepts, the same core principles, but trying to clarify and enhance how that understanding actually links and ties into the ultimate evaluation of risk.

Ms. Grove Casey

Well, I noticed that the new standard consistently refers to a system of internal controls versus internal control.

Ms. Louis

Yes. So part of that is to make sure that people understand that a system of controls is comprised of these five interrelated components, right? Because a lot of times when people talked about internal control in their minds, they're thinking control activities, the dual authorizations and the edit checks and things like that, where they want you to understand that it's truly a system of these five interrelated components. Now, certainly some of these components directly affect things and others indirectly affect them, so there is a differentiation of how the system affects your understanding, what you should gain an understanding of in order to assess risk. The use of the terms controls has been clarified to include, in essence, the policies and procedures that the entity establishes in order to achieve the control objectives of management and governance. They're ultimately the standard statements of what should or should not be done as it relates to probably more specifically the control activities, but also some of your IT related controls could be a control that's related to my policies and procedures, where then I also have a system of controls that also is important for me to understand.

Ms. Grove Casey

Well, are there any new definitions that relate to understanding the system of control?

Ms. Louis

So the key thing would be just to reinforce this concept of direct and indirect, because that is fundamentally one of the more enhanced changes that they made, where a

direct control is precise enough to address a risk of material misstatement at the assertion level. How do I make sure that this employee exists? Right? How do I know that my sales are complete? Like there's direct controls that are precise enough to address a risk at the assertion level, but there's also within your system of controls going to be indirect controls that just support the direct controls. So ultimately they're not precise enough on their own to prevent or detect and correct misstatements at the assertion level, but they're a foundation of having an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis. And so ultimately this does include things where we used to call them more entity-level controls, your control environment, your risk assessment process, your monitoring. Like one of the common terms was more of an entity level type control versus an assertion-level control. Now, it's direct and indirect will be the language that you will be applying, but it's still reaching towards that same concept.

Ms. Grove Casey

Well, what controls within the system of internal control is the auditor required to evaluate for design and implementation as part of risk assessment?

Ms. Louis

So, the new standard says that you need to evaluate the design of certain controls within the control activities component, but certain controls. It does include your general information technology controls, and that you are required to determine whether or not these certain controls have been implemented. Ultimately it is that you have things that are identified controls that often might be referred to as relevant controls or key controls. So depending on your audit methodology, your audit methodology may already have a concept about key controls. I have been teaching key controls forever, right? That isn't there. It's just that saying that you don't have to understand all the controls that directly affect the financial reporting process, but you need to understand certain of them, and those are going to be your identified or relevant or key controls.

Ms. Grove Casey

Well, are there any differences in the auditor's responsibility when indirect controls are involved over direct controls?

Ms. Louis

You do need to understand the ongoing tasks, activities, processes that are geared towards helping the

organization achieve its financial reporting objectives. My evidence that I have to get as far as understanding and evaluating things will still be a combination of inquiries and observation and inspection. But what I will be allowed to do is to exercise my professional judgment around the nature and extent of the procedures that need to be performed in order to meet these new requirements. It does not require the auditor to evaluate individual controls within these different components, control environment, control activities. I don't have to look at the individual controls within different components. However, I may identify certain controls within these components, that do help me feel better about risk management. And I now need to evaluate that the design and implementation of these controls, you're still going to have an obligation of understanding the design and implementation of controls that are still relevant or key to the process of preparing your financial statements.

Ms. Grove Casey

How does this requirement change when it's related to primarily direct controls within any component of internal control?

Ms. Louis

All right. So the key thing would be that I have, as far as these direct controls, remember that relate to a specific assertion level risk. And I need to make sure that these controls, that we have look at the design and implementation of them, which could include a control that addresses a risk that's deemed to be a significant risk, which we haven't talked about the new definition of significant risk yet, but ultimately these things that are higher end of the spectrum of risk, but it also includes controls over journal entries and other types of adjustments. Controls if you are intending to take a control reliance strategy and test the operating effectiveness of controls, well, then I need to evaluate the design and implementation of those controls in order to put together that control reliance plan, but it's also going to include any other control that based on the auditor's professional judgment, I consider necessary for me to be able to assess risk at the assertion level and design my further audit procedures. There's certain areas where they're going to presume that you're going to evaluate the design and implementation of controls, and then, there's going to be other controls that will be a matter of my judgment about what else I need to layer in and add on to beyond these core areas.

Ms. Grove Casey

Well, are the requirements for the information system and communication component, any different?

Ms. Louis

What's interesting about that component is, they're saying that that component can include both direct and indirect controls. Some of the components they're saying yes, control environment is more indirect, monitoring's indirect, but when you get to the information and communication component, they're saying it is a combination. And so ultimately there's going to be some elements of it that I'm saying lays the foundation for there to be reliable financial reporting, and then, there's going to be other elements of it that I need to look at because it relates to information processing activities and other elements of things that more directly relate to an assertion level risk, which could, by the way, include disclosures. As they think about processing for significant classes of accounts, classes of transactions, account balances, and disclosures, it does not require for me to once again, evaluate design and implementation of individual controls within the component. I need to evaluate the component. I need to evaluate the controls that are there that are direct influences of things, but I ultimately need to focus on what do I need to know and understand in order to properly identify and evaluate risk?

Ms. Grove Casey

Well, is there any further clarity provided related to the use of IT or general IT controls?

Ms. Louis

They do have some terms in there that they'll talk about general IT controls. They also talk about risks that arise from the use of IT. And so those terms are what you'll see in there as you're trying to figure out well, what is ultimately based on my judgment relevant to the process of risk assessment? I am required to identify general IT controls that address risks that arise from the use of IT, and to make sure that they are designed and implemented. General IT controls don't need to be identified for every IT process. I will have a combination of these controls that I will end up documenting and evaluating. I need to think about some of these actually might be control activities and some of these may be establishing a foundation for the IT environment. There is an appendix in SAS 145 that includes guidance to say, well, how do I identify what

IT applications and other aspects of the IT environment may be subject to risk? They do have a separate appendix and are giving you application materials, as you're now trying to take that component and really break it into both direct and indirect controls.

Ms. Grove Casey

I'm sure that appendix will be very helpful as people try to implement this standard. So is the process of identifying and assessing risk and material misstatement considered a static or a dynamic process?

Ms. Louis

It is meant to be dynamic, and it is meant to be something where you have an initial expectation about risks, and then, as you go through the audit process, you're going to further refine your risk identification and assessment. It is meant to be iterative and dynamic, both.

Ms. Grove Casey

Inherent risk is an important consideration in identifying and assessing risk of material misstatement. What is the nature of inherent risk factors? Let's talk about that a little bit.

Ms. Louis

It's going to be the characteristics of any event or condition that affects the susceptibility of something to be misstated, whether due to fraud or whether due to error. It is still related to a class of transaction and account balance or disclosure before I go through and think about controls. Things may be quantitative or qualitative in nature. It might be because of the complexity of accounting, the amount of subjectivity involved, how much there's been changes in these transactions, accounts, disclosures, how much accounting uncertainty do you have, where is it that you could be susceptible to management bias? Where could you be susceptible to fraud risk factors so that there still is the sense of inherent risk? That's more of a gut instinct where there's judgment that you make on having something that it has a risk factor, but then relatively, where is it on a relative scale of risk compared to other things I'm also considering in the same audit?

Ms. Grove Casey

How does the relativity of inherent risk get represented in the new risk assessment process?

Ms. Louis

The relativity of inherent risk is really important in this spectrum of inherent risk. And the spectrum of inherent risk is meant to provide a framework of reference, to determine the significance of where you have a higher likelihood and magnitude of misstatements, whether due to fraud or error. These inherent risk factors that I think about—accounting uncertainty, subjectivity bias, etc., are intended to assist me in focusing on the aspects of various conditions or events that exist within this financial reporting process. How susceptible are they to misstatement, the likelihood and to what degree, like what's the magnitude of the potential problems so, it's intended to facilitate a better focus on identifying risks of material misstatement at the assertion level by having a greater understanding of these inherent risk factors and how they affect the susceptibility of these assertions, to help the auditor do a better job at assessing inherent risk, so that I can do a better job at designing the nature, timing, and extent of my further audit procedures. In the end, it's still a combination and intersection of the likelihood and magnitude of problems. I am going to have some areas where on the relative spectrum of risk, I'm going to push it at the higher end of the spectrum. Sometimes things will be at the lower end of the spectrum. Sometimes it'll be somewhere in between, but that sense of pushing things along a spectrum of risk and properly categorizing my thoughts about them are going to be important.

Ms. Grove Casey

Well, how are relevant assertions defined?

Ms. Louis

A relevant assertion is an assertion about a class of transactions, account balance, or disclosure. It has an identified risk of material misstatement to it. So does it have a risk of material misstatement? There is at least a reasonable possibility. It's at least reasonably possible, right? As we think about the likelihood that a misstatement could occur, and if it were to occur, it would be possibly of a magnitude that would be material. Now, when we think about magnitude, it is ultimately going to be individually and in the aggregate like where we'd have these problems. As we think about a relevant assertion, it doesn't have to be on the highest end of the spectrum. It doesn't have to be probable that there's a material misstatement, but it has to be reasonably possible. It's more than remote that there could be an issue here that if this issue were to occur, it is a possibility that it would be of a magnitude that

would be considered to be material. And this determination that we make as far as what's relevant is based on your inherent risk factors.

Ms. Grove Casey

Well, is there anything else that was altered as it relates to inherent risk assessment?

Ms. Louis

It does require a separate assessment of inherent and control risk. As I'm trying to address risk of material misstatement at the relevant assertion level, it doesn't prescribe the specific method for doing that, but it does require that I look at inherent risk and I place things on a spectrum of risk considering my inherent risk factors. And then I separately decide, do I want to take a control reliance strategy or not? And then I come up with what would be my combined risk of material misstatement. And this is something where a lot of different audit methodologies already had you doing separate assessments. That might be something that's not new for you, but it also could be that some auditors were not doing the separate assessment because the old standard only said you had to assess risk of material misstatement. It didn't mandate the separate consideration of inherent risk from control risk, as you're now going through the process. And now you are, and there's going to be certain areas where this is going to be important, such as with SAS 143. When we talk about auditing accounting estimates and related disclosures, SAS 143 said for these areas of accounting estimation, you have to do a separate assessment of inherent and control risk. SAS 145 takes it a step further and says, not just with accounting estimates, but also anything as it relates to risk in the audit.

Ms. Grove Casey

Well, is there anything else that's been clarified related to control risk?

Ms. Louis

There is a requirement specifically now to say, you have to assess control risk at the maximum level. If you're not planning on testing the operating effectiveness of controls. What that means then is that your assessment of risk of material misstatement is the same as your assessment of inherent risk. If you're not taking a control reliance strategy, but ultimately if I am planning on taking a control reliance strategy, then I obviously will have an effect on what that combined

risk is. They also clarified to say that even if you don't plan on testing the operating effectiveness of controls, you still need to evaluate the design and implementation of controls in order to assist you in designing your substantive procedures. So ultimately that understanding about controls, the design and implementation is really a part of having a foundational basis in order to assess risk and put together my audit plan, but then separately, there's this additional consideration of what if you want to rely on these controls and do testing to prove they're operating consistently in a quality way. That's a totally separate and distinct consideration that you're going to have, but they want to make sure that you understand that your risk assessment procedures are going to influence your determination of the nature and timing of your substantive testing. Even if you're not planning to test the operating effectiveness of controls.

Ms. Grove Casey

Well earlier, you mentioned that there is an expectation to understand controls relevant to significant risks. And you mentioned then that we would be talking about what is a significant risk. So now I'm asking you that question. What is a significant risk?

Ms. Louis

...It used to be a significant risk requiring special audit consideration, right? The focus was on the response to the risk as opposed to the actual risk. And what they want to do is to say a significant risk should really focus on your inherent risk assessment. So ultimately it's focusing on the risk where my assessment of inherent risk is closer to the upper end of the spectrum of inherent risk due to the degree in which these inherent risk factors affect the likelihood and magnitude of misstatement. I can have a relevant assertion because remember a relevant assertion is it's reasonably possible, right, that there could be an issue here, but then what is a significant risk is going to be at the higher end of that spectrum. And when we think about controls, they want you to evaluate the controls, the system of controls, the control, the things that directly/indirectly affect those risks that are at the higher end of the spectrum, but also controls over journal entries, but also any other controls that the auditor determines are necessary.

Significant risks are going to be things like your related parties and significant unusual transactions, and ultimately could be certain accounting estimates that

might be on the higher end of that spectrum of risk. Now you're no longer required to determine whether a financial statement level risk is a significant risk; however, I am still going to have financial statement level risks that are still important that could affect my assessment about things at the assertion level, like management override of controls. But where I am looking at the significant risk is for these relevant assertions, which of these risks are at the higher end of the spectrum of risk.

Ms. Grove Casey

Well, how is a significant risk different than a significant class of transactions, account balance, or disclosure?

Ms. Louis

When we think about these significant class of transactions, account balances, disclosures, it's considered significant when it has an identified risk of material misstatement at the assertion level. So remember we said that you have an assertion level risk because it's reasonably possible. It's more than remote that, if something were to occur, it could be material. So that's significant account, class of transaction, disclosure, and then separately, you're going to have significant risks that are those relevant assertion risks that are at that higher end of the spectrum. This is going to include disclosures as we're thinking about these matters and these things, as far as these concepts are intended to clarify that the scope of an auditor's understanding of things, including information processing activities, that it's all relevant to my ability to identify, assess, and respond to risk.

Ms. Grove Casey

Well, does the new standard address the risk when the identification of significant classes of transactions, account balances or disclosures may not be complete?

Ms. Louis

They do. There's this new requirement, which I think would be a best practice anyhow, to once you're done with your risk assessment stand back and say, am I comfortable, did I identify everything that was significant? Did I consider where it was in the relative spectrum of inherent risk? And was there anything that I have not yet pulled into the process because we want to make sure that we stand back and think about the completeness of our thinking about our risk

assessments. And then, we do have to perform substantive procedures for each relevant assertion for each significant class of transaction, account, disclosure, regardless of the assessed level of control risk, right? And then, that's going to be the key—I have to perform procedures for each relevant assertion for each significant account, class of transaction, disclosure, but how much work I have to do as far as those substantive procedures go will depend on where I am in that relative spectrum of risk.

Ms. Grove Casey

Well, documentation has been, I don't want to say the bane of our existence, but certainly it's crucial in getting information out of one auditor's head into the review auditor's or any other person who comes beyond them, right to the understanding of what's occurring in that audit and how risks were addressed. So are there any new audit documentation requirements added as a result of this new standard?

Ms. Louis

It is getting the rationale for your more significant judgments about risk, but also making sure that you have documented your evaluation of the design of identified controls and determination of whether or not those controls have been implemented. You're still going to have that experienced auditor test that we previously had within the audit standards that you need to enable somebody with no previous experience with this particular audit to understand the nature, timing, and extent of your risk assessment procedures, the results of those procedures, the conclusions you reached, the rationale for significant judgments that were made, that were influenced by a variety of factors. And so it has to be something that's readily determinable from the documentation of the work performed and the evidence [collected].

SUPPLEMENTAL MATERIALS

New SAS on Risk Assessment

by Jennifer F. Louis, CPA

Overview

SAS No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, supersedes the existing AU-C Section 315 of the same title and amends various other professional standard sections related to the auditor's risk assessment, including obtaining an understanding of the entity's system of internal control and assessing control risk.

The guidance also addresses the economic, technological, and regulatory aspects of the environments in which audited entities and audit firms operate. It also recognizes the ability to use automated tools and techniques (including audit data analytics) when performing risk assessment procedures.

SAS No. 145 does not fundamentally change the key concepts underpinning audit risk, which is a function of the risks of material misstatement and detection risk. Rather, SAS No. 145 clarifies and enhances certain aspects of the identification and assessment of the risks of material misstatement to drive better risk assessments and, therefore, enhance audit quality.

Specifically, the new standard is intended to enable auditors to appropriately address the following:

- Understanding the entity's system of internal control, in particular, relating to the auditor's work effort to obtain the necessary understanding;
- Modernizing the standard in relation to IT considerations, including addressing risks arising from an entity's use of IT; and
- Determining risks of material misstatement, including significant risks.

The SAS becomes effective for audits of financial statements for periods ending on or after December 15, 2023.

Convergence with International Standards

The ASB has a strategic objective to converge with the International Standards on Auditing (ISAs). Accordingly, SAS No. 145 was developed using (ISA) 315, *Identifying and Assessing the Risks of Material*

Misstatement (Revised 2019) as the base starting point. ISA 315 (Revised 2019) is effective for audits of financial statements for periods beginning on or after December 15, 2021.

Principle-Based Approach

The new SAS builds on the foundational concepts relating to an audit of financial statements in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, (such as audit risk, identifying risks at the financial statement and assertion levels, and the definitions of *inherent risk* and *control risk*). SAS No. 145 is principles-based and audit methodology-neutral. The degree to which SAS No. 145 might impact an audit methodology may vary based on the particular audit approach and related audit methods, tools, or techniques.

The nature, timing, and extent of risk assessment procedures that the auditor performs to obtain the required understanding are:

- Matters of the auditor's professional judgment, and
- Based on the auditor's determination of the procedures that will provide sufficient appropriate audit evidence to serve as a basis for the identification and assessment of the risks of material misstatement.

Removal of Considerations Specific to Smaller Entities

Complexity of an entity's activities and its environment, including its system of internal control, is the primary factor driving the scalability in the application of SAS No. 145.

SAS No. 145 has removed the "Considerations Specific to Smaller Entities" sections previously included in the application material but has incorporated most of that content elsewhere in the standard, as appropriate, together with further revisions to promote scalability. SAS No. 145 recognizes that, although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex.

In addition, SAS No. 145 recognizes that some aspects of the entity's system of internal control may be less formalized but still present and functioning, considering the nature and complexity of the entity. When the entity's systems and processes lack formality, the auditor may still be able to perform risk assessment procedures through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the entity's processes through observation or inspection of documents).

Maintaining Professional Skepticism

The new standard contains new guidance related to maintaining professional skepticism.

SAS No. 145 contains several key provisions that are designed to enhance and emphasize the auditor's professional skepticism, including the following:

- Clarifying that an appropriate understanding of the entity and its environment, and the applicable financial reporting framework, provides a foundation for being able to maintain professional skepticism throughout the audit
- Highlighting the benefits of maintaining professional skepticism during the required engagement team discussion
- Highlighting that contradictory evidence may be obtained as part of the auditor's risk assessment procedures.

Understanding the Applicable Financial Reporting Framework

The new standard contains a new explicit requirement to understand the use of IT in the entity's structure, ownership and governance, and business model. SAS No. 145 defines the IT environment, which includes IT applications and supporting IT infrastructure, as well as the IT processes and personnel involved in those processes, that an entity uses to support business operations and achieve business strategies.

There is also a new requirement to obtain an understanding of how inherent risk factors affect susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements in accordance with the applicable financial reporting framework.

Understanding System of Internal Controls

Understanding certain aspects of the entity's system of internal control is integral to the auditor's identification and assessment of the risks of material misstatement, regardless of the auditor's planned controls reliance strategy. SAS No. 145 clarifies that the overall understanding of the entity's system of internal control is achieved through understanding, and evaluating certain aspects of, each of the following components of the system of internal control (and performing the related requirements to obtain such an understanding.

Each component comprises a collection of controls, which may be direct or indirect. While differing requirements exist with respect to each component, SAS No. 145 clarifies the auditor's responsibilities, including the requirements to evaluate the design of certain controls within the control activities component and determine whether such controls have been implemented.

Internal Control Terminology

The term *internal control* has been changed to *system of internal control*, and the definition has been updated to reflect that it comprises five interrelated components.

The use of the term *controls* has been clarified by including the following definition in the standard as policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance.

- Policies are statements of what should, or should not, be done within the entity to effect control. Such statements may be documented, explicitly stated in communications, or implied through actions and decisions.
- Procedures are actions to implement policies.

Direct controls are controls that are precise enough to address risks of material misstatement at the assertion level.

Indirect controls are controls that support direct controls. Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a

misstatement will be prevented or detected on a timely basis.

Evaluating the Design and Implementation of Internal Controls

The new standard revised requirements to evaluate the design of certain controls within the control activities component, including general information technology (IT) controls, and to determine whether such controls have been implemented.

The controls for which the auditor is required to evaluate design and determine implementation are referred to as “identified controls” in SAS No. 145. Such controls might also be referred to as “relevant controls” or “key controls” in some audit methodologies.

Understanding the Indirect Controls

The following is the auditor’s general expected effort as it relates to indirect controls, such as the control environment, the entity’s risk assessment process, and the entity’s process for monitoring the system of internal control:

SAS No. 145 includes requirements to understand, and evaluate certain aspects of, the control environment, the entity’s risk assessment process, and the entity’s process to monitor the system of internal control components. The auditor’s required understanding includes the ongoing tasks and activities, or processes, geared to the achievement of the entity’s financial reporting objectives.

Audit evidence for the auditor’s understanding and evaluation may be obtained through a combination of inquiries and other risk assessment procedures (for example, corroborating inquiries about the entity’s processes through observation or inspection of documents). The auditor exercises professional judgment to determine the nature and extent of the procedures to be performed to meet the requirements of SAS No. 145.

SAS No. 145 does not require the auditor to evaluate the design or determine the implementation of individual controls within these components. However, the auditor may, based on the auditor’s professional judgment, identify controls within these components that address risks of material misstatement at the assertion level for which the auditor evaluates design and determines implementation.

Understanding Primarily Direct Controls

Primarily direct controls include control activities. SAS No. 145 includes specific requirements to understand certain controls within the control activities component that address risks of material misstatement at the assertion level.

For the identified controls that address risks of material misstatement at the assertion level, the auditor is required to evaluate the design and determine whether the controls have been implemented. The identified controls include:

- Controls that address a risk that is determined to be a significant risk.
- Controls over journal entries and other adjustments as required by AU-C §240.
- Controls for which the auditor plans to test operating effectiveness in determining the nature, timing, and extent of substantive procedures, which include controls that address risks for which substantive procedures alone do not provide sufficient appropriate audit evidence.
- Other controls that, based on the auditor’s professional judgment, the auditor considers are appropriate to enable the auditor to assess the risks of material misstatement at the assertion level and to design further audit procedures.

Identified controls also include those general IT controls that address risks arising from the use of IT.

Understanding the Information System and Communication

SAS No. 145 includes a requirement to understand, and evaluate certain aspects of, the information system and communication component. This component is primarily direct controls, but may be indirect controls.

For this component, the auditor’s understanding includes, among other things, the flows of transactions and other aspects of the entity’s information-processing activities for significant classes of transactions, account balances, and disclosures as well as the entity’s communication of significant matters.

SAS No. 145 does not require the auditor to evaluate the design or determine the implementation of individual controls within the information and communication component. It is important to note that the auditor's identification and evaluation of controls in the control activities component is focused on information-processing controls, also known as transaction controls.

Risks Arising from the Use of IT and General IT Controls

SAS No. 145 now defines the terms "risks arising from the use of IT" and "general IT controls." SAS No. 145 requires the auditor to identify general IT controls that address the risks arising from the use of IT and to evaluate their design and determine their implementation.

General IT controls need not be identified for every IT process. General IT controls are identified based on the risks arising from the use of IT. To identify the risks arising from the use of IT, the auditor identifies the IT applications and other aspects of the entity's IT environment that are subject to such risks. Such IT applications and other aspects are identified based on the identified controls that address the risks of material misstatement at the assertion level.

Assessing Risk of Material Misstatement

The auditor's risk identification and assessment process is iterative and dynamic. In obtaining the understanding required by SAS No. 145, initial expectations of risks may be developed, which may be further refined as the auditor progresses through the risk identification and assessment process.

Defining Inherent Risk

Inherent risk factors are characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls.

Scalability of Inherent Risk

The new standard provides enhanced guidance on factors to consider when establishing the relativity of inherent risk.

Depending on the degree to which the inherent risk factors affect the susceptibility of an assertion to

misstatement, the level of inherent risk varies on a scale that is referred to as the *spectrum of inherent risk*. The spectrum of inherent risk provides a frame of reference in determining the significance of the combination of the likelihood and magnitude of a misstatement.

Relevant Assertions Defined

The definition of a relevant assertion was revised to clarify that an assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement, taking into account the likelihood and magnitude of a misstatement. A risk of material misstatement exists when:

- There is a reasonable possibility of a misstatement occurring (that is, its likelihood), and
- If it were to occur, there is a reasonable possibility of the misstatement being material (that is, its magnitude).

SAS No. 145 also clarifies that there is a reasonable possibility when the likelihood of a material misstatement occurring is more than remote.

The determination of whether an assertion is a relevant assertion continues to be made before consideration of any related controls (that is, the determination is based on inherent risk).

Separately Assessing Inherent Risk

The new standard requires a separate assessment of inherent and control risk for risks of material misstatement at the relevant assertion level.

SAS No. 145, however, does not prescribe a specific method for making such risk assessments nor does it require a combined assessment of inherent risk and control risk. The auditor's separate assessments of inherent risk and control risk may be performed in different ways, depending on preferred audit techniques or methodologies, and maybe expressed in different ways.

Assessing Control Risk

There is a new requirement to assess control risk at the maximum level such that, if the auditor does not plan to test the operating effectiveness of controls, the

assessment of the risk of material misstatement is the same as the assessment of inherent risk.

In other words, tests of the operating effectiveness of controls are required to support a control risk assessment below the maximum level.

When the auditor does not plan to test the operating effectiveness of identified controls, the auditor's evaluation of the design and determination of the implementation of controls may still assist in the design of substantive procedures. When identified controls are designed effectively and implemented, risk assessment procedures may influence the auditor's determination of the nature and timing of substantive procedures to be performed (for example, the auditor may determine to perform inspection rather than external confirmation or to perform procedures at an interim date rather than at period end).

Significant Risk Redefined

The new standard redefined the term significant risk to focus not on the response (that is, whether a risk requires special audit consideration), as was the case with the previous definition, but on the inherent risk assessment. The definition in SAS No. 145 focuses on those risks for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.

Significant risks also include those that are to be treated as a significant risk in accordance with the requirements of other AU-C sections (that is, AU-C section 240 and AU-C section 550, *Related Parties*).

SAS No. 145 no longer requires the auditor to determine whether a financial statement level risk is a significant risk. However, identified risks of material misstatement at the financial statement level may affect the auditor's assessment of significant risks at the assertion level.

SAS No. 145 acknowledges that the determination of whether a risk is a significant risk requires the exercise of professional judgment. AU-C §330 continues to include special audit considerations in the form of specific requirements related to significant risks

because of the nature of the risk and the likelihood and potential magnitude of misstatement related to the risk.

Significant Class of Transactions, Account Balance, or Disclosure Redefined

A class of transactions, account balance, or disclosure is considered significant when it has an identified risk of material misstatement at the assertion level (that is, there is one or more relevant assertions as defined). The determination of whether a class of transactions, account balance, or disclosure is significant is made before consideration of any related controls (that is, the determination is based on inherent risk).

The introduction of the concept of a significant class of transactions, account balance, or disclosure is intended to clarify the scope of the auditor's understanding of the entity's information-processing activities as well as the auditor's responsibilities related to the identification and assessment of, and responses to, risks of material misstatement.

"Stand Back" Requirement

The standard adds a requirement to evaluate the completeness of the auditor's identification of significant classes of transactions, account balances, and disclosures.

For material classes of transactions, account balances, or disclosures that have not been determined to be significant classes of transactions, account balances, or disclosures (that is, there are no relevant assertions identified), SAS No. 145 requires the auditor to evaluate whether the auditor's determination remains appropriate.

Materiality is in the context of the financial statements. Accordingly, classes of transactions, account balances, or disclosures are material if there is a substantial likelihood that omitting, misstating, or obscuring information about them would influence the judgment made by a reasonable user based on the financial statements.

Linking to Detailed Audit Plan

A conforming amendment was added to perform substantive procedures for each relevant assertion of each significant class of transactions, account balance, and disclosure, regardless of the assessed level of control risk (rather than for all relevant assertions

related to each *material* class of transactions, account balance, and disclosure, irrespective of the assessed risks of material misstatement, as previously required).

Audit Documentation


Audit documentation requirements have been altered, including requiring documentation of:

- The evaluation of the design of identified controls, and determination of whether such controls have been implemented.
- The rationale for significant judgments made regarding the identified and assessed risks of material misstatement.

The form, content, and extent of audit documentation that is sufficient to enable an experienced auditor having no previous experience with the audit to understand the nature, timing, and extent of the risk assessment procedures and the results of those procedures, including the conclusions reached and the rationale for the significant professional judgments made, depend on various factors, including the need to document a conclusion or the basis for a conclusion otherwise not readily determinable from the documentation of the work performed or audit evidence obtained.

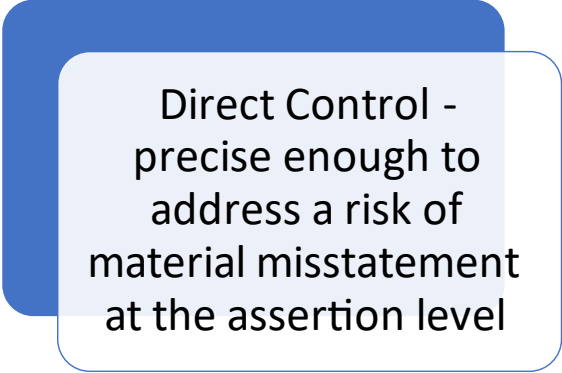


Gain an Understanding

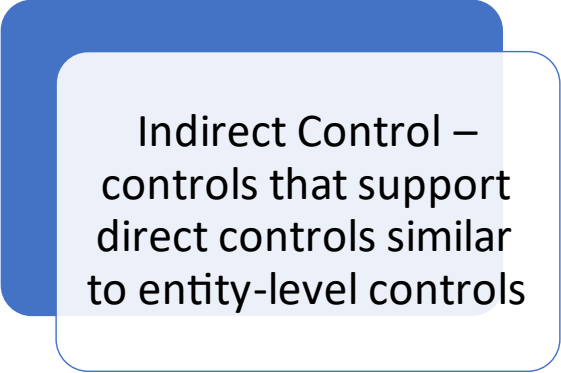
- Understand the use of IT
 - Understand the entity's model, structure, and governance
 - Personnel
 - Processes and how they are used to support objectives
- 



New Definitions



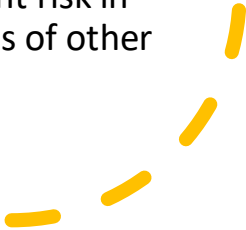
Direct Control -
precise enough to
address a risk of
material misstatement
at the assertion level



Indirect Control –
controls that support
direct controls similar
to entity-level controls









Significant Risks

- An identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or
 - that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.
- 

Inherent Risk Factors

Any event or condition that affects the susceptibility of something to be misstated, whether due to fraud or whether due to error



Control Risk Clarifications

- If not testing operating effectiveness of controls, assess control risk at maximum
- Regardless of testing operating effectiveness of controls, evaluation of design and implementation of controls needed to design substantive procedures



GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the impact of SAS 145 on the key concepts underlying audit risk.
2. Discuss the difference between direct and indirect controls that are a part of a system of internal control.
3. Discuss the changes SAS 145 makes to the documentation requirements for auditors.

B. Suggested Answers to Discussion Problems

1. SAS No. 145 does not fundamentally change the key concepts underpinning audit risk, which is a function of the risks of material misstatement and detection risk. Rather, SAS No. 145 clarifies and enhances certain aspects of the identification and assessment of the risks of material misstatement to drive better risk assessments and, therefore, enhance audit quality.

Specifically, the new standard is intended to enable auditors to appropriately address the following:

- Understanding the entity's system of internal control, in particular, relating to the auditor's work effort to obtain the necessary understanding;
 - Modernizing the standard in relation to IT considerations, including addressing risks arising from an entity's use of IT; and
 - Determining risks of material misstatement, including significant risks.
2. *Direct controls* are controls that are precise enough to address risks of material misstatement at the assertion level. For example, control activities.

Indirect controls are controls that support direct controls. Although indirect controls are not sufficiently precise to prevent, or detect and correct, misstatements at the assertion level, they are foundational and may have an indirect effect on the likelihood that a misstatement will be prevented or detected on a timely basis. For example, the control environment, the entity's risk assessment process, and the entity's process for monitoring the system of internal control.

Information system and communication controls are primarily direct, but may be indirect.

3. Audit documentation requirements have been altered, including requiring documentation of:

The evaluation of the design of identified controls, and determination of whether such controls have been implemented.

The rationale for significant judgments made regarding the identified and assessed risks of material misstatement.

The form, content, and extent of audit documentation that is sufficient to enable an experienced auditor having no previous experience with the audit to understand the nature, timing, and extent of the risk assessment procedures and the results of those procedures, including the conclusions reached and the rationale for the significant professional judgments made, depend on various factors, including the need to document a conclusion or the basis for a conclusion otherwise not readily determinable from the documentation of the work performed or audit evidence obtained.

PART 3. SMALL BUSINESS

Analytical Procedures in Review Engagements

While audits are the most rigorous of services a practitioner may provide, review engagements provide limited assurance. Reviews for many businesses may be the most cost-effective engagement when third parties need the financial statements. Reviews consist of inquiries and analytical procedures. While inquiries are important and can help identify items to be further investigated, analytical procedures are one of the most powerful tools a practitioner can use in determining how a business is doing.

For a closer look at the analytical procedures used in review engagements, let's join Kurt Oestricher, CPA and a partner with Oestricher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

So today we want to talk about something that is very commonly used by auditors and reviewers—really even people who are preparing statements probably want to use these, we're talking about analytical procedures. Now this segment is not going to be focused on the preparation side so much. We're, obviously, looking at the audit or the review side, I mean, but let's talk a little bit about analytical procedures and it's not just ratios. I mean, reviewers and auditors use analytical procedures for a variety of reasons when they're conducting these types of engagements. It's not just that it's required. Let's talk about what is required and then talk about why else you would want to use analytical procedures.

Mr. Oestricher

Yes. And, it goes back to something I heard Alan Winters say many, many years ago. We were joint presenting at a conference. And for those of you that do not know Dr. Winters, and that's probably most of y'all out here, he passed away unfortunately a few years ago, but he was on the very first Accounting and Review Services Committee that created SSARS 1. So he was one of the seven ladies and gentlemen that actually said, okay, we're going to invent this new thing that's in between a compilation and an audit and we're going to call it a review, and it's going to be a level of assurance between no assurance and reasonable assurance, and they decided we'll call that limited assurance. So they had to decide, well, what procedures are we going to require in these review engagements that will give this concept of limited assurance?

And again, remember, they're literally making this up as they go. There's a very specific thought process, but they were really determining, what do we have to do?

And so, you look at your audit toolbox and you can confirm, and you can recalculate and you can observe and you can inquire and you can analyze. And, they chose, and we've done a previous segment on the inquiries and, they said, well, there's really two procedures that you perform in an audit that help direct you to where a departure may be from your framework. For the context of this, let's just assume it's U.S. GAAP. So I'll always say a GAAP departure, but we know it could be a framework departure if you're using an income tax basis. So they intentionally, after much thought process said, the limited assurance can be provided if you perform the procedures that will direct you toward where a departure may be. If those procedures are not indicative of a departure being in that area, that you're performing the analytical procedures on, then you can stop. You're done; that's enough to give limited assurance. Now, if those inquiry or analytical procedures are indicative or indicate that, well, wait a second. My expectation was X, actual amount was Y, there's a wide gulf there. We can't explain it. Yes, then you can go back to that audit toolbox. So that's the perspective that we need to understand when we're looking at analytical procedures in a review engagement. As you said, it's not just, oh, the standards say I have to do this, so let me calculate a few ratios or use a third-party practice aid that says, do this, this, this, and this. It is a matter of thinking about, where could departures exist? Do analytical procedures that would help you say, Hey, is there an issue there? So if receivables are an issue, days of sales in receivable and receivable turnover, those are the type things you would look at.... Most people understand that cutoff is important for a manufacturer or retailer. So you're going to do analytical procedures on gross profit percentage. So that's the main context we're about to get

into. What's exactly required that you have to do, and then how to go about it, but it's more than just what is there really, when you look at the required elements, and I know it might be your next question, but there's like two things you have to do. And then there's two concepts in that.

Ms. Grove Casey

So let's talk a little bit more about what are the required analytical procedures. Are there things that we have to do?

Mr. Oestrieher

Yes. When you, when you look at section AR-C 90, and again, there's four bullet points. From a pure application standpoint, two of those say, this is what you have to do. You have to compare with comparable information from a prior period. So, and I think every person that has ever done review engagements has always done this. And, this is very similar. You talked about the concepts in audits when you're doing your preliminary analytical procedures and in an audit to help say, Ooh, what are the areas that look kind of out of whack a little bit. That's what you're doing here. So comparison with comparable information from prior periods. So now the one thing I want to stress here is we perform a review of financial statements. We are not required to perform a review of the trial balance. If you look at AR-C 90 I promise you, it doesn't say review of trial balances. It says review of financial statements, which has measurement issues. It has presentation and it has disclosure, but we tend to focus on the measurement because remember the vast, vast, vast majority of your non-public companies and non-public companies are under the purview of SSARS review engagements, they're not going to give you a set of financial statements. When you start, what are they going to give you? They're going to give you a trial balance. And so we focus on measurement. So the first thing we want to do when we're looking at comparable information, we don't do this comparison at the trial balance level. Meaning if the client has 143 accounts, I'm not looking at the comparison of 143 accounts. We always load the client's trial balance into our trial balance software. And I know different people use different types of software, but we also produce these grouping schedules. So if you're grouping seven items that are your fixed asset accounts, that includes your contra account, the accumulated depreciation, if the total of those seven accounts is 1.3 million, while I'm comparing that 1.3 million with prior years full amount cause that's what's

presented on the financial statement. Now, remember if you're going to be showing this as disclosures for something like fixed assets, you might say, Hey, I want to look at the individual components also because we are going to be disclosing that. So in that example, you might want to look at both the financial and the disclosures, but something like prepaid insurance, where you have eight different prepaid insurance accounts, you definitely want to just look at the total dollar amount there. And then that's the judgment. So when you're saying comparable information, remember, we want to look at the information that's going to be presented in the financial statements.

And when you're doing that, also, it took me a while for my staff to get this concept, sometimes the strongest indicator of a departure is when there's no movement in the account whatsoever. So if last year it's a C Corp and deferred taxes were 184,000, and it's the exact same amount this year, that probably means what? As we're expecting, the client hasn't recorded deferred taxes, so we just make a note of that and say, Hmm, we're going to have to do that. More importantly, it's things like estimates, like maybe the allowance for doubtful accounts has not changed. Right? So that would be an element within the receivables, accrued absences. So accrued asset retirement accounts. So often people go, oh, look, yeah, I'm only looking for a change of more than 5%, and I truly do not think that is the most appropriate approach. You have to look at the nature of the account, and say, okay, what is my expectation? It should move. So exactly comparable information from the prior period is one of the two that I'll say that's required. The other one is comparing disaggregated revenue data as applicable. And, that's the question I get often. What do you mean by disaggregated? Well, when you look at most financial statements, they just have one line item for revenue. And as we know most people now, I don't think there's any exceptions at this point where anyone has not adopted ASC 606, and so one of the things that we've learned from this, and it's not explicitly written anywhere, but the line revenues is now analogous to revenues from contracts with customers. Other income is like interest income, or gain or loss on sale of fixed assets.

People actually call that other income and expense. So we actually have a different terminology for income from revenue. So the way I am now interpreting this under SSARS, your disaggregated revenue are the separate ways that an entity will track their revenues from contracts with customers. Let me use my CPA

firm as an example. If you look at our general ledger, you would see revenues from compilations, revenues, from reviews, tax returns, estate planning, consulting, and Kurt talking to other people, which is, we call it speaking/teaching. So we have these various revenue streams, but if we were to publish financial statements, we would not show those in external financial statements, those six or seven revenue streams. You would just say revenues. So this is where you would look at more of your detail. And it's not just a comparison to prior year.

When, when we talk about the actual steps, we're going to talk about coming up with predictions and using other data. But this means that you're not going to just be looking at revenue from a comparison to prior year. That is one account that you will in fact break down if you will, and look at the individual components. So when you look at required analytical procedures, again, there's four, there's a section A, B, C, and D in that particular area. But the other one says, consider plausible relationships among both financial and non-financial information. So what they're telling us there, and they're not saying exactly what area of your financial statements you are required to perform this on, but it says your analytical procedures should incorporate things that are not from the trial balance. What do we mean by that? I just talked about revenues, because we did some reviews of hotels and it is the most classic example.

I know people may have heard me say this before, but what is some non-financial information that I could use if I'm reviewing a hotel that would give me plausible relationships to revenue? Well, it's the number of rooms the hotel has. It is the number of days in the year, which remains constant. It is their expected room rate, which I can go on the web and see what they typically advertise. But, you have the high-end New York City hotels or the downtown New Orleans hotels compared with the Hilton Garden Inn, or the Hilton Hampton INN, out on I-49 in Alexandria, you're going to have different rates depending on where you are, and then the expected occupancy rate. So the occupancy rate and the number of rooms and the number of days, that's non-financial data, but there's a direct relationship with that.

Number of employees—if you're doing analytical procedures on payroll or rental lease expense, we know there is about to be a new lease standard, but square footage, take annual rent divided by square footage. Is

that reasonable for the area that you're in? Again, because that's going to be a lot different if you are in downtown Miami versus downtown Bunko, Louisiana. There's going to be a huge discrepancy in the square footage that you're going to pay. So it doesn't tell you which accounts or analytical procedures. Now it does say, when applicable, I just can't imagine any elements, key elements of a financial statement of an entity that is required to have a review that you would not have some of these key items that you stop and think, how does that number get there? Is there a certain number of people that create that through wage expense or what are the physical assets that I have that I can create revenue?

Those are the questions that you need to ask yourself because if you're only looking at financial information from the financial records of the company, for lack of a better term, you sort of have inbred analytical procedures, because errors would be inherent if you're using the same data. The errors aren't going to present themselves as well as if you take a step back and say, well, how could their salaries be \$143,000 per employee? If we have a light manufacturing company in central Louisiana, something's not right there. Then the other thing they have under the required procedures is comparing recorded amounts or ratios from recorded amounts to expectations developed by the accountant. So that is where we see the relationship where there's references to the exact same requirements in both the auditing standards and the review standards.

And I can tell you there's a direct relationship because this first appeared in... SSARS 10. When I was on the committee, some 20, 25 years ago, and the Auditing Standards Board had said, okay, if you're going to use analytical procedures for substantive testing, you have to develop an expectation. You have to compare it, those steps we blatantly stole. I think it was SAS 96. We said, if that makes sense in an audit, then that's what makes sense in a review. So, we're about to talk about a lot of other things, but ultimately when you believe you're finished with your analytical procedures, take a step back. If I have a comparison with prior information, if I have disaggregated revenue data, if I have used plausible non-financial relationships and if I have done this comparison to expectations and I have expectations for all of my analytical procedures, then, you've met the minimum requirements. You're going to do more than that, but at that point, you know, you've met the minimum requirements.

Ms. Grove Casey

Well, and what you mentioned earlier when it comes to those expectations, right? So if you have an account that you should have an expectation as to whether or not that account is going to move, and maybe your expectation is different because of some non-financial information that is part of the business environment that we've had for the last year or so, right. It makes a big difference, which year you're looking at 2020, 2021, totally different business environment for virtually every business on the planet. And you've got those expectations and you should have an expectation that, that number's going to go up, going to go down, going to do something. It's unlikely that it would stay static for most of those numbers. Either way you need to document it because otherwise it's like we didn't do it.

Mr. Oestrieher

Yes, exactly. And like, one of the things we found for 2020 was people were putting COVID relief payments as revenue. And we said, no, there's no customer contract here. This is just a gift from Congress. There was an election year and they needed to buy your votes. Now I know that sounds very cynical. I believe a lot of the issues when you go back and look at it, you go, wow. The first Cares Act we absolutely needed. There was so much uncertainty, there was panic. I don't know if you can call it panic amongst leadership in our firm, but there was a tremendous amount of concern about what is the next 12 months going to look like. Now, six months later we're like, wow, they need to turn the spigot off here. They're getting a lot of money, but some of my clients it was like, if you're getting certain reimbursements from Medicaid and Medicare, if you're in the medical field, that was an issue because we said, okay, is that revenue from a contract with customers? But, ultimately, we said, no. The customer is the patient. Medicaid, Medicare is just the third-party payer, and there was no contract. They just said, here's the money. By the way, we'll later tell you how you need to account for it. So that was a huge issue that came up. Those were the things that made you think, we just didn't say, oh yes, that's revenue. So, that's the concept here. We didn't go get evidence and say, well, I need to know whatever the government gave you. It is just, that's the kind of thinking that you need to have in a review, it's more of a global thought process if you will.

Ms. Grove Casey

So let's talk about some other considerations when we're performing procedures in review engagements.

What kinds of other things, because as you said the requirements, those are the minimum, those aren't necessarily the only thing that you're going to do, you just want to make sure that you at least have that covered?

Mr. Oestrieher

You have to have that. This is an area that we've improved a lot in our firm. I can talk about this because I think the statutes of limitations have run but many years ago, and I'm talking about 25, 30 years ago now, when I first became partner in charge of accounting and auditing in our firm, I realized that our review engagements kind of looked like audits without confirmations. We were backing up everything. And that's when I kind of took a deep dive into this standard. It was right when I started teaching a lot of CPE and I realized, wait a second, we have stuff in here that's just garbage, because we had done so much audit work. We were pretty sure we could provide limited assurance. And at the end we said, oh rats, look, the program says, we have to do analytical procedures. So fortunately, we had trial balance software that could print, I think 125 different ratios. So we printed 'em out and put it on there. Most of them had nothing to do with trying to find a GAAP departure. The specific one I could and remember, and I can laugh about it now, because I don't think my peer review can go back that long, we had the Altman Z score in one of ours. Now for those of you that are younger, you probably never studied this, but I studied it in college. A very smart person named Professor Altman studied five companies that had gone bankrupt in the 1970s, public companies like Braniff Airlines was one of them. He did a bunch of multiple regression analysis and came up with this formula where they add a coefficient to five different ratios and you got a score. And based on that score, it's going to be indicative of whether or not you're going to go bankrupt. I had that in some of my review documentation. First of all, my clients were healthy. This only should be used if you're trying to say, Hey, is there going to be a problem with liquidity and the underlying data and the underlying data came from Braniff Airlines. How does that affect ABC laundromat in Alexandria, Louisiana? So watch that if you are not sure. The following question, if you cannot say what GAAP departure is this analytical procedure helping me to find, where I think that there's a risk and again, we don't do risk assessment, but if I can't answer that question, you need to consider is this suitable? People often ask, Kurt, how many analytical procedures do you typically perform in a review engagement?

The answer is between 8 and 12. Because I, of course, always do my first one—my comparison with prior year information. My second one is always revenue because so many things drive off of revenue. And then, just depending on the client, it is going to be a hodgepodge of other items. Obviously, if there's any specific lending ratios or key lending ratios or debt covenants, then absolutely, I'm going to calculate those because that is going to be material to the user. And it's not just calculating those—remember it's underlying understanding. What are the accounts in the numerator and denominator? Are they subject to significant management estimate? It's not going to be just calculating that ratio. It's going to now be saying, okay, receivables is a big part of this ratio or inventory. So I'm going to do additional analytical procedures on those accounts that appear in the numerator or in the denominator; usually they're in the numerator.

You know, it can be the place but many times we're talking about the numerator there. So that's important. Ask yourself why. And, and if you're doing analytical procedures on deposits, which hasn't changed for the last four years, slap yourself in the face and quit doing that. Cause you don't need me to say, oh, I'm doing, we have three different utility accounts. And so I'm taking the \$1,500 that's in deposits and dividing it by the three utility providers for an average of \$500 per utility provider. That math may be all working good, but what departure are you looking for? And, I say that because one of my staff did that one time and had no analytical procedures on interest expense where there was significant debt. Yep. And again, to be fair, I kind of let this person, I said, look, you've done a couple of these, let's go on your own, and so, she and I had a good discussion on suitability, and folks I could have easily been that staff person too, 30 years ago when I was first learning all this. That is what is just so very, very important. The next thing, after you look at suitability, you want to look at the reliability of the data that you're using for the expectations, especially when you're using the non-financial data. So if I'm looking at full-time equivalent employees, well, then that means that I'm trying to figure out how many total hours will work. So if I just ask the client that information and remember you do not have to get any supporting evidence to corroborate management's responses to inquiries, but if it's an in-house person that really we notice isn't too strong, then maybe that is not quite as reliable if I know I'm getting it straight from a third party payroll report by a third party provider, or I'm looking at that number myself. So the more reliable the underlying data is

obviously the stronger your analytical procedures. And that doesn't mean you can't use data that is not as reliable as other. I just think you need to take that into account and determine do I need to supplement this with additional inquiries or other analytical procedures just as we conclude in an audit work paper that we have sufficient, appropriate audit evidence? Well, with SSARS 25, we actually have to determine if we have sufficient, appropriate review evidence.

They're continuing to use more and more terminology in review engagements that used to be found only in the audit engagement. Now it's still inquiry and analytical procedures. We're still providing limited assurance, but we had never used those terms before. I got yelled at 20 years ago on the Committee (ARSC), because I used the term review evidence and Diane Cohen and said, no, no, no, Kurt, we say review procedures. We don't get evidence in reviews. So those are the types of factors that are contemplated by the Committee. When you talk about suitability and reliability and we've already talked about developing an expectation for certain ratios or key metrics that you're looking at, you can use budgets, you can use prior year history. In fact, for your comparison to last year, that's probably what you are going to use, what's happening prior year, along with adjusting that for information you have and what I always call your initial inquiries and what has happened in the economy, like you said with COVID, inflation.

So if I'm doing these reviews in 2022 for 2021, this is a delivery company. I expect fuel prices to go up. My expectations should be what at least a 20 to 30% increase in fuel costs. So develop those expectations again for every analytical procedure. If you have not documented an expectation, you're probably not quite as up to speed with standards as you should be. And then, ultimately, we are going to say, here's the recorded amount or here's the expectation, here's our calculated or recorded amount, and then, based on your understanding of the high level of precision of your expectation, you say, okay, it's good now we're fine. And in other words, on the example of room revenue in a hotel, if I had expected \$2,343,647.22. First of all, I would round that to the \$2.3 million, because it's not expected to be that high a level of precision.

So if my expectation is 2.3 million and the general ledger is \$2,240,000, well there's a \$60,000 deviation. I don't think there's a \$60,000 GAAP departure. I think we're right in line, and, we're good. Now compare that if I am doing a review of a nursing home and I have

high level of precision, this is the Medicaid rate per day, right? And these are the number of patient days. My level of precision is zero. If it's off \$700, something's wrong. Now I may consider that to be a material, but I'm pretty sure that's a departure because we know that's exactly what you should get. So that's judgment, that's why I'd never recommend to have a first or second year staff person do this, perform review engagements, because you have to apply a lot of professional judgement in the reviews.

Ms. Grove Casey

Well, let's talk about what happens when we need to go further. The analytical review procedure has sparked something, right? We think it's off. Maybe there's a GAAP departure, like you just mentioned, or it's not in line with what we think it should be. What do we do then?

Mr. Oestrieher

Yes. If we know that it's a GAAP departure, then we just have a whole other section. We do reporting, you go, okay, now we have to evaluate this. But if it's just indicative and we don't know if there's a GAAP departure or not, that's when you probably make additional inquiries of management. Certainly, that's when you would go to what I call the auditor toolbox. Remember the engagement letter says we do not contemplate performing procedures ordinarily performed in an audit, such as inspection, observation, recalculation. It doesn't mean you can't do it. That's when you would do it where you would dig down a little bit further. And again, that's where you would either say, okay, looks like my expectation was flawed and so the actual recorded amount is correct. The flaw was with my expectation, or you say, wow, we did find an amount that needs to be adjusted. Often when we do go down that road, we say here's an adjustment. We propose it to the client and then they pass off on the adjustment. So that is the investigation. Fortunately for us, because many of our review clients, they have highly competent CPAs and we generally don't have that, but on occasion it comes up and it's almost always in an area that's subject to management's estimates, such as allowance for doubtful accounts or certain accruals. That's typically where we would find those areas.

Ms. Grove Casey

So I mentioned it before that, you know, if we don't document the expectation, then it's like we didn't do it, where we didn't even consider it, which is unfortunate

because I think, I hope, that most practitioners consider it. Maybe they just have a little writer's cramp or didn't quite get it all into the work papers, but let's talk about the documentation of analytical procedures and what we need to have in the workpapers.

Mr. Oestrieher

See Debbie, you're showing our age. It's not writer's camp. We don't write. It's carpal tunnel that causes that.... I remember the good old days when used to have to write everything down on a piece of paper, you and I every now and then reminisce about what it was like in the 1980s. You're a little bit younger than me, you're a lot younger than me, but back in the 1980s, it was a little bit different, but yes, documentation, if you didn't document it, you didn't do it. So the first thing I always suggest is, and it's not required just the type of analytical procedure, the template that I've developed in our firm, the Excel template says, are you doing a ratio, a trend analysis or predictive test? And the only reason that I do that is years ago, we used to focus so much on the ratios, when I truly believe those predictive tests we were using non-financial data, that's really the most powerful. So I just want to make sure we're using a good mixture, so that's why we document that, but absolutely not required, but you do have to document the source and the reasoning for the expectations. So whether it's prior years that you're using or budgeted, not only talk about what you used, but why you believe it's appropriate. And for your comparison to prior years, it's almost always going to be it's reasonable because we do not expect major changes in the business. Now I know the COVID year was a little bit different, but for most of your businesses, it is just game on, same thing as they've had previous years moving forward for many companies. Now, some of them experienced phenomenal growth. If 15 years ago you had a Blockbuster go in the other direction. So I understand there are outliers, but for many of your clients, the expectations just said, steady as she goes, which is fine. You just have to document that the calculation, you actually have to show whatever it is, your analytical procedure, the ratio show how you calculated that. That is not any big deal. We always document the compare. So here's the actual amount, here I always show that difference. And then the conclusion, remember we always conclude in a review engagement, so I document my conclusion, I would say in 90 to 95% of all analytical procedures I've ever performed, the conclusion is based on the review evidence obtained, and you can use the term review evidence. I don't say

the account appears to be properly stated. I say, no further review procedures are necessary. When I say the account is properly stated, that is more like forming an opinion in an audit, right?

And remember, that's what we're doing. So, that wording is actually important. We just say no further procedures on that five to 10%. Where further procedures are required. I say, Nope, here's the reason why I think they are, and then, I reference that work paper where I have those audit like procedures. So that's the documentation. And so I strongly urge companies or CPA firms that are performing review engagements, and I'm assuming if you're listening here, that means you read the section of AR-C 90, that deals with just the analytical procedures and the documentation. When I did that, about 20 to 25 years ago, our firm became much more proficient in our review engagement and much improved in our documentation, and it made our peer reviewer happier too.

Ms. Grove Casey

Well. And it probably not only made your engagements more effective, but also more efficient, not just the quantity of data you were collecting.

Mr. Oestrieher

Right, right. You're right. It improved our skills. We had less work papers, but we were much more effective with our review. So efficiency is important for more profitability, but effectiveness is important for compliance with standards. We always put compliance with standards first, but it was one of those win-win [situations]. We became more effective and more efficient because we better understood what the standards required us to do.

SUPPLEMENTAL MATERIALS

Analytical Procedures in Review Engagements

by Kurt Oestrieher, CPA

Introduction

Review engagements under SSARS require that the accountant obtain limited assurance that the financial statements are in accordance with the Applicable Financial Reporting Framework selected by management (usually United States GAAP). The two primary procedures performed in a review engagement in order to obtain the limited assurance are inquiries and analytical procedures.

Required Analytical Procedures

AR-C 90.25 requires that analytical procedures be designed and performed to address the following:

- All material items in the financial statements, including disclosures
- Areas in the financial statements where the accountant believes there are increased risks of material misstatements.

Materiality is required to be determined on all review engagements that have adopted the provisions of SSARS 25. Because of the specific language in AR-C 90.25, it is easy to conclude that at least one analytical procedure should be performed on any line item in the financial statements that is above the calculated materiality. Because a two-year comparison is one of the required analytical procedures (as discussed below), it is the author's opinion that all material balances would have at least this one analytical procedure performed. Financial statement elements that have an increased risk of material misstatement is typically where an accountant will focus additional analytical procedures.

AR-C 90.26 contains the authoritative guidance related to the nature and extent of analytical procedures to be performed in a review engagement in accordance with SSARS. The basic requirement is:

The accountant should apply analytical procedures to the financial statements to identify and provide a basis for inquiry about the relationships and individual items that appear to be unusual and that may indicate a

material misstatement. Such analytical procedures should include the following:

- Comparing the financial statements with comparable information for the prior period
- Considering plausible relationships among both financial and nonfinancial data
- Comparing recorded amounts or ratios developed from recorded amounts to expectations developed by the accountant
- Comparing disaggregated revenue data, as applicable.

The required elements above will produce at a minimum, 2 analytical procedures. A comparison to prior year will always be performed (if the entity produced financial statement or had financial records from the prior year), and an analytical procedure shall be performed on revenue if it is possible to obtain disaggregated revenue. Disaggregated revenue data may be any one of the following, and the list is not intended to be all-inclusive

- Geographic data
- Revenue stream (room rental, parking, restaurant revenues for a hotel)
- Monthly or quarterly trends

AR-C 90.27 requires the accountant to consider the following when designing and performing analytical procedures

- The suitability of particular analytical procedures
- Consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of the information available.
- Develop an expectation of recorded amounts or ratios and evaluate whether that expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or in the

aggregate, may cause the financial statements to be materially misstated

- Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and compare the recorded amounts or ratios developed from recorded amounts, with the expectations.

Considerations when Performing Analytical Procedures in a Review Engagement

While AR-C 90 enumerates the minimum requirements in performing analytical procedures in a review engagement, the accountant should consider the likelihood that the analytical procedures performed will reveal potential departures from the applicable financial accounting framework. It is important that the accountant have a thorough understanding of the industry, client, and specific accounting rules related to the industry.

Suitability of particular analytical procedures

Many programs will calculate numerous ratios from an entity's trial balance, but many of those ratios will not be suitable to determine potential departures when evaluated on its own. It is important that the accountant does not conflate analytical procedures with ratios. Ratio analysis is just one of many forms of analytical procedures available. The root of "analytical" is "analyze". An analysis may take many forms, not just a mathematical computation. Scanning a general ledger or reading a disclosure is an analysis.

An accountant should consider the critical areas of financial reporting for a particular entity and ensure that appropriate analytical procedures are performed in these areas. Close attention should be paid to financial statement elements that have the following characteristics:

- Complex accounting rules
- Subject to management estimate
- New standards issued
- Likelihood of fraudulent financial reporting
- Elements subject to lending or bonding requirements

An accountant should focus more on the information provided by analytical procedures instead of the volume of procedures performed. For less complex entities that do not have transactions subject to either management estimation or complex accounting rules, it can be expected that fewer analytical procedures are necessary in order to perform the review in accordance with SSARS.

Reliability of Data in Developing Expectations

When developing expectations, the data that is used can be obtained from many different sources. Data from external sources are typically more reliable than data obtained from the client, and data that is not obtained from the general ledger is typically more reliable than data obtained from the general ledger. While review standards do not require verification of any data source common sense dictates that many external sources can be readily observed. For example, if an accountant were performing review procedures to predict room rental revenue for a hotel, the number of rooms in a hotel is fixed and observable. This data may be more reliable than obtaining the number of employees from management to perform a predictive test of salary and benefits. However, that same test may contain more reliable data if obtained from a third-party payroll processor.

An accountant should not ignore analytical procedures where the most reliable form of data is not available, but instead determine whether it is necessary to supplement such analytical procedures with additional analytical procedures or inquiries. The potential for material misstatement in the account and the overall risk of material misstatement would be factors the accountant would consider in determining if sufficient review evidence has been obtained.

Developing Expectations

Performing an analytical procedure without a predetermined expectation is not sufficient based on current review standards. This standard is for all analytical procedures, not just ratios, predictive tests or trend analysis.

An example of an analytical procedure is scanning the salaries expense general ledger. An expectation may be that all entries are from the payroll journal, with the exception of a general journal entry to accrue salaries at the end of a period. Any other general journal entries or entries from other sources, such as a purchases

journal, would not be within the expectation and inquiries of management should be made to determine why such entries are included in salary expense.

The expectation developed can be very specific or general. The range to which a deviation from the expectation can be considered unusual depends on the nature of the procedure and the accounts involved. The comparison of the current year financials or trial balance to the prior year financials or trial balance is typically based on very broad expectations, such as trending higher or trending lower. However, if an accountant is performing an analytical procedure on payroll tax expense as a percentage of payroll, the precision of the expectation is much higher. If the calculated amount exceeds 9%, in most cases this would trigger additional inquiries based on current federal and state payroll tax rates.

Investigating the Results of Analytical Procedures

The accountant should determine whether or not the analytical procedures performed indicate a departure from the applicable financial reporting framework. If there are no unusual deviations from expectations and the accountant is satisfied that the scope of the analytical procedures performed is appropriate, the accountant may move forward with the review engagement.

If the accountant is not satisfied with the results of analytical procedures performed, the following issues should be considered.

Determine if the deviation from the expectation is acceptable

Very few analytical procedures will yield a result that is exactly equal to the expectation. Judgement is required by the accountant when evaluating the results of analytical procedures. When the results of analytical procedures vary from expectations, the accountant should first look at the development of the expectations to determine if all relevant factors were considered. Once the accountant determines that the expectation was properly developed, then the accountant should consider unnatural deviations (departures from the applicable financial reporting framework).

Additional procedures when the accountant is not satisfied with the results of analytical procedures performed.

When analytical procedures indicate a potential departure from the applicable financial reporting framework, the accountant may choose from one or more of the following alternatives:

Perform additional analytical procedures

If the accountant believes the initial analytical procedure was poorly designed, substitute analytical procedures may be performed. This is preferable when the accountant believes that a departure likely does not exist.

Perform inquiries of management

When the results of analytical procedures are not satisfactory and the accountant believes the analytical procedure was properly designed, inquiries of management designed to assist the accountant in understanding why the deviation exists would be appropriate. Often, the responses to such inquiries may reveal that adjustments are necessary to the expectation and the uncertainties can be resolved. In other cases, the accountant may not yet be satisfied and must continue investigating unexplained discrepancies.

Performing procedures ordinarily performed in an audit

Review standards are clear that review procedures do not anticipate performing procedures that are ordinarily performed in an audit and that an accountant is not required to obtain evidence to corroborate analytical procedures or management inquiries. However, an accountant is not precluded from performing procedures ordinarily performed in an audit when there is no other method of resolving discrepancies noted in analytical procedures or inquiries. The accountant should document the reasons for such procedures and the objective of the procedures to ensure that there is a specific reason for performing such procedures.

In most cases, the accountant is able to resolve discrepancies using one or a combination of the procedures above. The resolution is typically either a proposed adjustment, modification of the accountant's report when the departure is not corrected by management, or the accountant obtaining sufficient review evidence that the analytical procedure did not yield the proper result and there is no departure.

In rare instances when the accountant has unresolved doubts and cannot conclude based on the analytical

procedures performed, the accountant should withdraw from the engagement as review standards do not allow for a disclaimer conclusion.

Documenting Analytical Procedures in a Review Engagement

AR-C 90.137-139 provides guidance on documentation in a review engagement. The requirements in these paragraphs are general in nature, however the following best practices will ensure compliance with the documentation requirements:

- Document the type of analytical procedure performed (trend, ratio, etc.)
- Document the expectation and source of data for the expectation
- Document the analytical procedure performed and necessary calculations
- Document the comparison of the recorded or calculated amount to the expectation
- Document the conclusion and any additional procedures performed

Various third-party practice aids have sample documentation forms for all types of analytical procedures. Many firms use tailored word and excel documents, while other firms will use engagement specific documentation. Regardless of the methodology used, the following characteristics are required for all documentation in review engagements:

- The nature, timing, and extent of review procedures performed
- The review evidence obtained and the accountant's conclusion
- Any significant issues that arose, and the disposition of the issue
- Who performed the work and the date such work was completed

- Who reviewed the work and the date and extent of the review

Summary

Properly designing and performing analytical procedures is critical to the successful completion of a review engagement and issuance of the appropriate review report. An accountant should be familiar with the requirements of AR-C 90 related to analytical procedures and apply that knowledge in the planning and execution of the related review procedures. Effective analytical procedures will lead to efficiencies and proper execution of a review engagement.

Required Analytical Procedures

- Comparing comparable information for the prior period
- Considering plausible relationships among both financial and nonfinancial information
- Comparing recorded amounts or ratios from recorded amounts to expectations developed by the accountant
- Comparing disaggregated revenue data, as applicable



When performing procedures

Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance

Considerations when performing procedures

- Determine suitability of particular analytical procedures
- Consider reliability of data for expectations
- Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to provide the accountant with limited assurance
- Determine if the deviation from the expectation is acceptable

Investigating the results of analytical procedures

- Additional inquiries of management
- Performing other review procedures
- Performing procedures ordinarily performed in an audit



GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the considerations the accountant should contemplate when designing and performing analytical procedures in a review engagement.
2. Discuss the requirements related to expectations in using analytical procedures in a review engagement.
3. Discuss best practices related to documentation of analytic procedures.

B. Suggested Answers to Discussion Problems

1. AR-C 90.27 requires the accountant to consider the following when designing and performing analytical procedures
 - The suitability of particular analytical procedures
 - Consider the reliability of data from which the accountant's expectation of recorded amounts or ratios is developed, taking into account the source, comparability, and nature and relevance of the information available.
 - Develop and expectation of recorded amounts or ratios and evaluate whether that expectation is sufficiently precise to provide the accountant with limited assurance that a misstatement will be identified that, either individually or in the aggregate, may cause the financial statements to be materially misstated
 - Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation and compare the recorded amounts or ratios developed from recorded amounts, with the expectations.
2. Performing an analytical procedure without a pre-determined expectation is not sufficient based on current review standards. This standard is for all analytical procedures, not just ratios, predictive tests or trend analysis.
3. AR-C 90.137-139 provides guidance on documentation in a review engagement. The requirements in these paragraphs are general in nature, however the following best practices will ensure compliance with the documentation requirements:
 - Document the type of analytical procedure performed (trend, ratio, etc.)
 - Document the expectation and source of data for the expectation
 - Document the analytical procedure performed and necessary calculations
 - Document the comparison of the recorded or calculated amount to the expectation
 - Document the conclusion and any additional procedures performed

The expectation developed can be very specific or general. The range to which a deviation from the expectation can be considered unusual depends on the nature of the procedure and the accounts involved. The comparison of the current year financials or trial balance to the prior year financials or trial balance is typically based on very broad expectations, such as trending higher or trending lower. However, if an accountant is performing an analytical procedure on payroll tax expense as a percentage of payroll, the precision of the expectation is much higher. If the calculated amount exceeds 9%, in most cases this would trigger additional inquiries based on current federal and state payroll tax rates.

GLOSSARY OF KEY TERMS

Analytical Procedures— Evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data. Analytical procedures also encompass such investigation, as is necessary, of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Audit Risk— the risk that an auditor may issue an unqualified report due to the auditor's failure to detect material misstatement either due to error or fraud.

Direct Control—a control precise enough to address a risk of material misstatement at the assertion level

Estimated Current Value—the amount at which the item could be exchanged between a buyer and seller, each of whom is well informed and willing, and neither of whom is compelled to buy or sell

Indirect Control—controls that support direct controls, not precise enough on their own to prevent or detect and correct misstatements at the assertion level

Net Worth—the difference between the total assets and total liabilities

Peer Review— an examination of the audit work of a CPA firm by another CPA firm.

Risk of Material Misstatement—inherent risk times control risk or the risk that financial statements contain material misstatement but the internal control cannot prevent or detect such misstatement.

Statement of Financial Condition— the basic personal financial statement that presents estimated current values of assets, amounts of liabilities, income taxes on the differences between the estimated current values of assets and amounts of liabilities and their tax bases, and net worth at a specified date.

Statement of Changes in Net Worth—presents the major sources of increases in and decreases in the overall net worth

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BY SPEAKER

Speaker	Month	Speaker	Month
Russ Madray	Jan-Feb, May	Kurt Oestricheer	Jan-Mar, May
Jennifer Louis	Jan, Mar, May		

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

1. According to Russ Madray, prior to 1982, which of the following was the primary basis of measurement for personal financial statements?
 - A. Historical cost.
 - B. Estimated current value.
 - C. Market value.
 - D. Fair value.

2. According to Russ Madray, which of the following is the basic personal financial statement?
 - A. Cash flow statement.
 - B. Income statement.
 - C. Statement of financial condition.
 - D. Statement of retained earnings.

3. According to Russ Madray, the estimated current value of an investment in a partnership that is a going concern should be shown as which of the following?
 - A. Comingled with the assets added to those of the individual and its liabilities included with the personal liabilities.
 - B. Its net amount.
 - C. Only the residual amount.
 - D. Separately but with similar type assets and liabilities, so two lines for cash and two lines for liabilities.

4. According to Russ Madray, receivables in personal financial statements are typically presented at which of the following amounts?
 - A. Face value.
 - B. The amount expected to be received if they were factored.
 - C. Discounted amount expected to be collected.
 - D. Fair market value.

5. According to Russ Madray, which of the following is unique requirement to personal financial statements?
 - A. Income taxes payable.
 - B. Estimated income taxes.
 - C. Estimated income taxes on the difference between the estimated current values of the assets and the estimated current amounts of the liabilities.
 - D. Displaying net worth.

Continued on next page

6. According to Jennifer Louis, in 2020 deficiencies in the auditor's risk assessment procedures made up approximately what percentage of all matters for further consideration found in peer reviews?
 - A. 5%.
 - B. 10%.
 - C. 15%.
 - D. 25%.
7. According to Jennifer Louis, SAS 145 becomes effective for audits of which of the following?
 - A. Periods ending on or after December 15, 2022.
 - B. Periods ending on or after December 15, 2023.
 - C. Periods ending on or after December 31, 2022.
 - D. Periods ending on or after December 31, 2023.
8. According to Jennifer Louis, which of the following has been explicitly added that relates to an auditor gaining a better understanding of to better identify and assess audit risk?
 - A. The entity's source of capital.
 - B. The entity's sources of revenue and expenses.
 - C. The entity's use of IT.
 - D. How an entity's inventory is funded.
9. According to Jennifer Louis, which of the following types of controls is precise enough to address a risk of material misstatement at the assertion level?
 - A. Indirect control.
 - B. Direct control.
 - C. Entity-level control.
 - D. The control environment.
10. According to Jennifer Louis, which of the following COSO internal control components is a combination of direct and indirect controls?
 - A. The control environment.
 - B. Monitoring.
 - C. Information and communication.
 - D. Risk assessment.
11. According to Kurt Oestricher, AR-C 90 requires how many analytical procedures in a review engagement?
 - A. Two.
 - B. Three.
 - C. Six.
 - D. Eight.

Continued on next page

12. According to Kurt Oestrieher, how many analytical procedures does he typically do in a review engagement?
 - A. Only two.
 - B. Between 4 and 6.
 - C. Between 8 and 12.
 - D. Between 16 and 20.
13. According to Kurt Oestrieher, which of the following standards requires the accountant to determine if there is sufficient, appropriate review evidence?
 - A. SSARS 10.
 - B. SSARS 19.
 - C. SSARS 21.
 - D. SSARS 25.
14. According to Kurt Oestrieher, which of the following needs to be documented related to expectations used in analytical procedures?
 - A. The source and reasoning for the expectations.
 - B. The type of analytical procedure used.
 - C. The assumptions used by management.
 - D. The non-financial data used.
15. According to Kurt Oestrieher, which of the following is important for compliance with standards?
 - A. Efficient use of procedures.
 - B. Effectiveness.
 - C. More workpapers documenting work performed.
 - D. An engagement letter.

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How would you rate the topics covered in the May 2022 **CPE Network® A&A Report**? Rate each topic on a scale of 1–5 (5=highest):

	Topic Relevance	Topic Content/ Coverage	Topic Timeliness	Video Quality	Audio Quality	Written Material
Personal Financial Statements	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
SAS 145	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Analytical Procedures 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 May 2022 issue of **CPE Network® A&A Report** did you like the most, and why?

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

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

How would you rate the effectiveness of the speakers in the May 2022 **CPE Network® A&A Report**? Rate each speaker on a scale of 1–5 (5 highest):

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

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

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

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CHECKPOINT LEARNING NETWORK

CPE NETWORK®

USER GUIDE

REVISED SEPTEMBER 3, 2021

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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.
- **What Does It Mean to Be a CPE Sponsor?:** Should you decide to vary from any of the requirements in the 3 methods noted above (for example, provide less than 3 full CPE credits, alter subject areas, offer hybrid or variations to the methods described above), Checkpoint Learning Network will not be the sponsor and will not issue certificates. In this scenario, your firm will become the sponsor and must issue its own certificates of completion. This section outlines the sponsor's responsibilities that you must adhere to if you choose not to follow the requirements for the delivery methods.
- **Getting Help:** Refer to this section to get your questions answered.

IMPORTANT: This User Guide outlines in detail what is required for each of the 3 formats above. Additionally, because you will be delivering the training within your firm, you should review the Sponsor Responsibilities section as well. To get certificates of completion for your participants

following your training, you must submit all the required documentation. (This is noted at the end of each section.) Checkpoint Learning Network will review your training documentation for completeness and adherence to all requirements. If all your materials are received and complete, certificates of completion will be issued for the participants attending your training. Failure to submit the required completed documentation will result in delays and/or denial of certificates.

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

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

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

Copyrighted Materials

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

“Group Live” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance

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

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

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

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

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

Requesting Participant CPE Certificates

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

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

Email: CPLgrading@tr.com

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Group Internet Based” Format

CPE Credit

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

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

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

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

Advertising / Promotional Page

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

Monitoring Attendance in a Webinar

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

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

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

Examples of polling questions:

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

Additional Notes on Monitoring Mechanisms:

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

Real Time Moderator During Program Presentation

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

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

Make-Up Sessions

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

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

Awarding CPE Certificates

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

Subscriber Survey Evaluation Forms

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

Retention of Records

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

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

Finding the Transcript

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

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

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

Requesting Participant CPE Certificates

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

Mail: Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008
Email: CPLgrading@tr.com
Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Self-Study” Format

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

Self-Study—Print

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

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

Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

Self-Study—Online

Follow these simple steps to use the online program:

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



the answer company

THOMSON REUTERS

CHECKPOINT LEARNING

Contact Us



Sign In or Register

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Support



Search courses

Need to get up to speed on
new revenue standards?

We can help.

Virtual Conference: Nov. 13 – 14

Register Now

Move forward

Checkpoint Learning provides training and tools to keep you and your team up to date and looking forward in an industry full of change and opportunity.



Webinars

Fit learning into your schedule with instructor-led webinars ranging from one to eight hours.

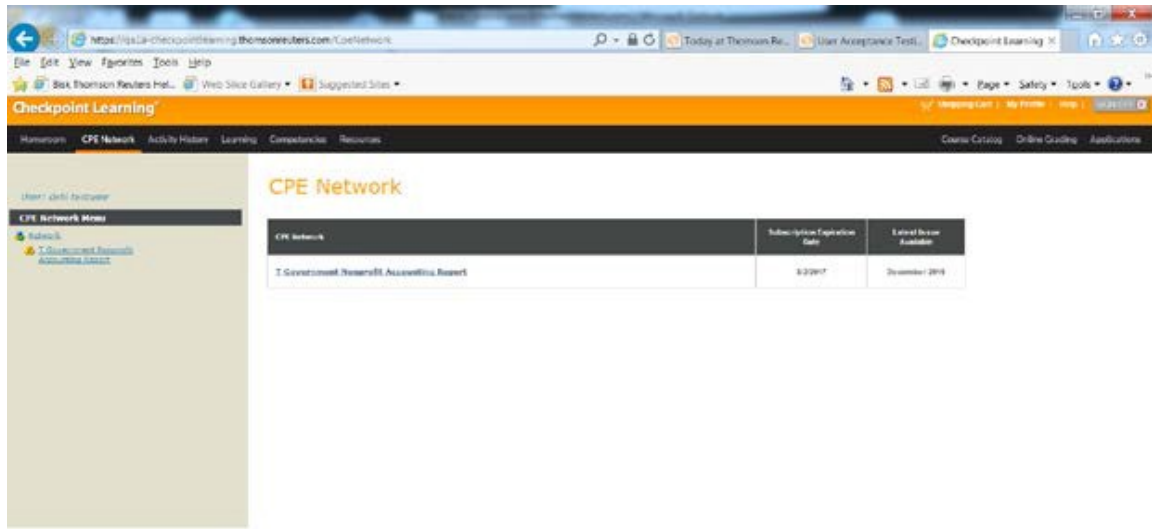


Seminars and conferences

In-person networking, dynamic instructors, nationwide locations plus vacation destinations.

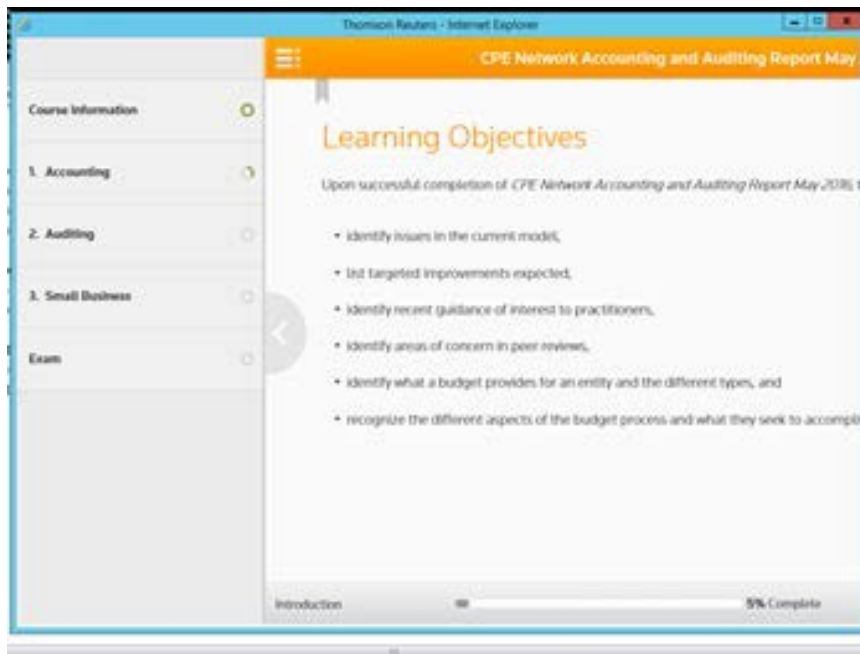


- In the **Network** tab, select the Network Report for the month desired.



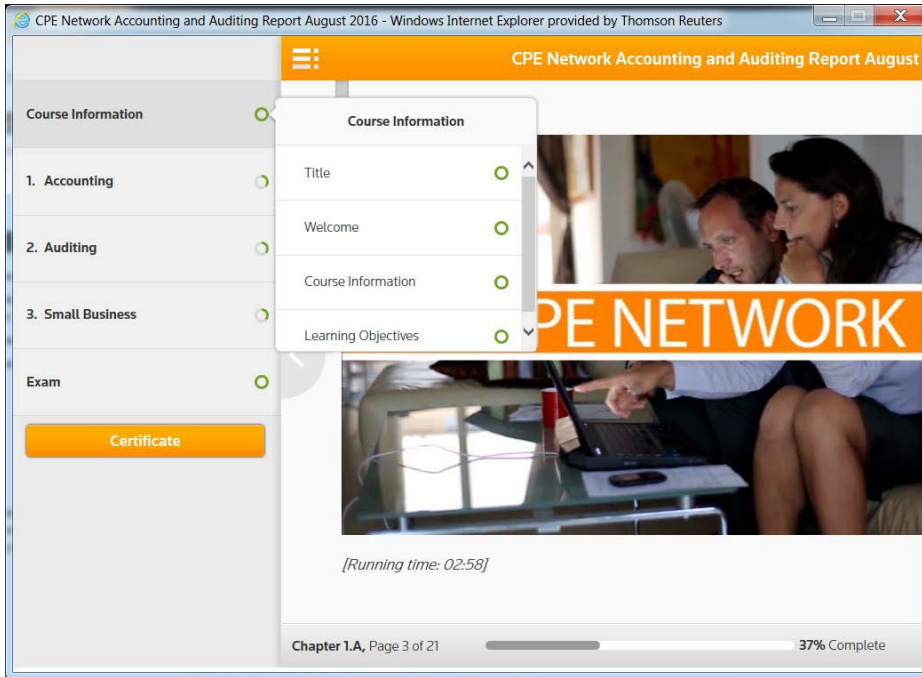
<https://go1a-checkpointlearning.thomsonreuters.com/CpeNetwork/CpeNetworkDetails/Page?SubscriptionId=177994>

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

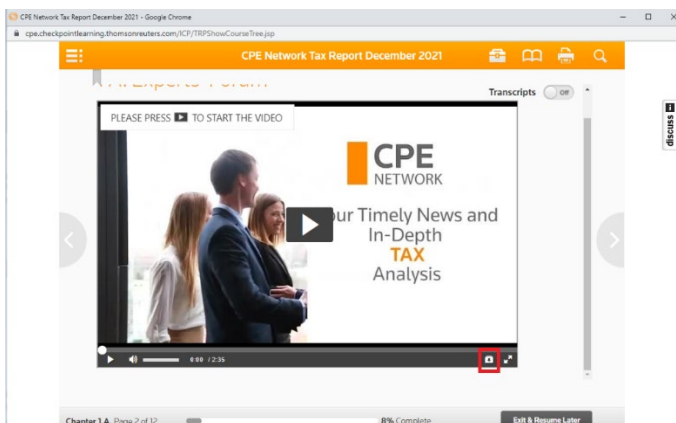


Click down to access the dropdown menu and move between the program Chapters.

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



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



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

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.

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](#)

CHAPTER 1: ACCOUNTING

Liabilities and Equity: Another Look at the Model

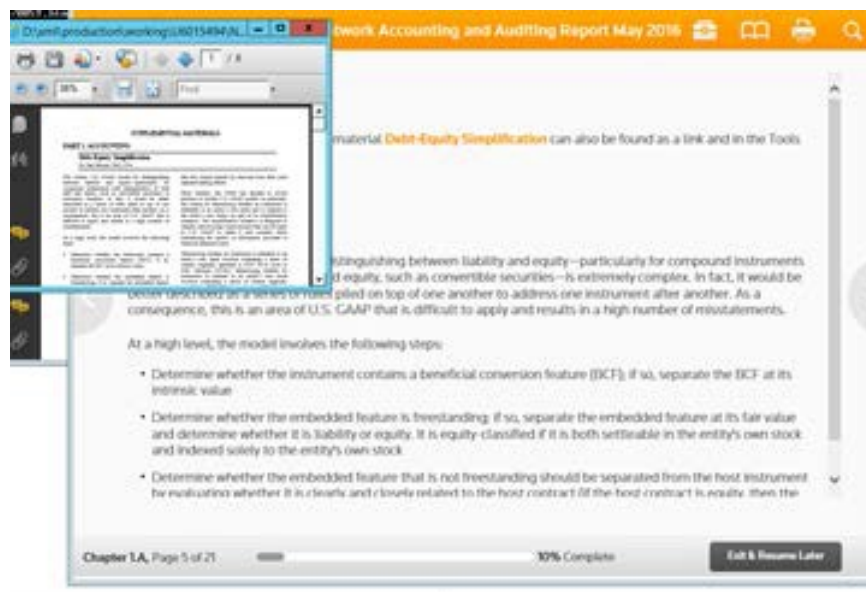
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For more on the targeted improvements in this area, let's join Paul Munter, professor in practice for the University of Colorado at Boulder, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today, we want to talk a little bit

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



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

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

The screenshot shows a web interface for the 'CPE Network Accounting and Auditing Report July 2016'. The main content area is titled 'Suggested Answers to Discussion Problems'. It contains three numbered items:

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

At the bottom of the page, it says 'Chapter 3.A, Page 20 of 20' and '100% Complete'. There is an 'Exit & Resume Later' button.

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 main content area is titled 'Course Exams Completed'. It contains the following text:

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

At the bottom of the page, it says 'Course, Completed' and '100% Complete'. There is an 'Exit & Resume Later' button.

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

Additional Features Search

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

Search Results are displayed with the number of hits.

Print

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

What Does It Mean to Be a CPE Sponsor?

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

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

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

CPE Sponsor Requirements

Determining CPE Credit Increments

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

Program Presentation

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

information available in advance:

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

- Record of participation (the original sign-in sheets, now in an editable, electronic

signable format)

- Copy of the program materials
- Timed agenda with topics covered and elements of engagement used
- Date and location of course presentation
- Number of CPE credits and field of study breakdown earned by participants
- Instructor name(s) and credentials
- Results of program evaluations

Appendix: Forms

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

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

Getting Help

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

Support Group	Phone Number	Email Address	Typical Issues/Questions
Technical Support	800.431.9025 (follow option prompts)	checkpointlearning.techsupport@thomsonreuters.com	<ul style="list-style-type: none">• Browser-based• Certificate discrepancies• Accessing courses• Migration questions• Feed issues
Product Support	800.431.9025 (follow option prompts)	checkpointlearning.productsupport@thomsonreuters.com	<ul style="list-style-type: none">• Functionality (how to use, where to find)• Content questions• Login Assistance
Customer Support	800.431.9025 (follow option prompts)	checkpointlearning.cpecustomerservicet@thomsonreuters.com	<ul style="list-style-type: none">• Billing• Existing orders• Cancellations• Webinars• Certificates