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CPE NETWORK

ACCOUNTING & AUDITING REPORT

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Topics for future editions may include:

- FASB Update
- Transitioning to SAS 145
- Comfort Letters

EXECUTIVE SUMMARY

PART 1. ACCOUNTING

Personal Financial Statements.....3

Kurt Oestricher, CPA, discusses the types of engagements that can be performed on personal financial statements and the statements that are typically produced. [Running time: 32:09]

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

- Determine the most common personal financial statement basis
- Identify reporting entity types
- List the financial statements and the methods of valuation used
- Identify benefits to the compilation engagement for personal financial statements

PART 2. AUDITING

Nonaudit Attestation Options.....23

Jennifer Louis, CPA reviews the different nonaudit attestation options. [Running time: 31:19]

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

- Identify attest services and their benefits
- Identify what distinguishes a direct examination
- Determine if the Code of Conduct applies to attestation engagements

PART 3. SMALL BUSINESS

Risk Management.....45

Jennifer Louis, CPA considers risks an organization or a client may identify and disclose in the financial statements, as well as risk management. [Running time: 32:36]

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

- Determine approximately how many organizations have an ERM process in place
- Identify the timeframe for risks disclosed in the financial statements or notes
- Define severe effects of a risk
- Identify the current cap on FDIC insurance for depositors
- Identify cybersecurity risk mitigation tools

ABOUT THE SPEAKERS

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

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

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EXPERT ANALYSIS AND COMMENTARY

PART 1. ACCOUNTING

Personal Financial Statements

The GAAP accounting guidance for personal financial statements is found in ASC 274. While individuals, couples, and families typically use personal financial statements for financial planning purposes, there are other uses.

For more on the valuation used for the different assets and liabilities, and other considerations in creating personal financial statements, let's join Kurt Oestrieher, CPA and a partner with Oestrieher and Company in Alexandria, Louisiana, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk about something that many people don't think about unless they are applying for a loan or they are trying to get a line of credit for something, and that is personal financial statements. To begin with, let's talk about whether or not there is GAAP for personal financial statements.

Mr. Oestrieher

Surprisingly, there is. This is one of those things that, for nerds like me, who have studied the history of generally accepted accounting principles, this is something the FASB wouldn't be concerned with. There used to be an AICPA Statement of Position (SOP 82-1) that [stated], "This is how we handle it"—and I think that was Level D in the old GAAP hierarchy—but when the GAAP Codification came into existence about 13 or 14 years ago, the FASB even took guidance that they had never issued. Remember, they took old AICPA Statements of Position, and then Accounting Research Bulletins, and APB Opinions, so these were all AICPA-issued guidance.

We actually have, in the GAAP Codification, criteria that say, "This is what should be in a personal financial statement, this is how you measure it, and this is how you disclose it." It is in Section 274. I think that is the first thing that we need to understand is that if we are engaged to prepare—and remember, you compile, audit, or review, we will talk about all three—if you are engaged, the first question you have to ask is, "How do these things get measured?" In most cases, you are going to want to follow United States GAAP.

Now, there is certainly no prohibition from using a special-purpose framework, such as income tax basis, or anything like that, but I think it would be useless because income tax basis is your tax basis. In other words, the bank or lender doesn't care that you paid \$85,000 for your house in 1969, they are worried about what it is worth now; or how much money you put into your retirement account, what it is worth now. I can tell you that I have never, ever, ever, ever, not one time in my life, issued tax basis, but I can see where it could be useful if someone is doing tax planning. There are some instances out there where, possibly, tax basis would be appropriate. I can never imagine [using] contractual basis, and cash basis really doesn't apply because you are talking about balance sheet items, so all you would show is your cash. Tax basis would be the only special-purpose framework I think you should even consider.

I am going to go on a limb here and cite a statistic that has no backing whatsoever. I am going to say that 99 percent of all personal financial statements are actually issued using the criteria and guidance in United States GAAP, the GAAP Codification, Section 274.

Ms. Grove Casey

Let's talk about what the reporting entity is—because it could vary.

Mr. Oestrieher

Correct, and that is the second question you ask your client is, "Okay, whose information?" Now, if you are talking about someone who is single and has no relatives, it is easy; it is John Person or Jane Person. In most cases, it is going

to be a married couple. In other words, when you say personal financial statement, it doesn't mean just one individual. You can absolutely (and, in fact, it is most common if someone is married) to show that person and his or her spouse's information combined. What you have to look for there is, are we in a community property state or not? Is there a post or premarital agreement that [there are] certain things you have no ownership in? And if you are showing both people, well then, all those assets will be there. If you have disclosures, now you are going to disclose which spouse owns which asset—so, that is more of a disclosure issue—but if you are showing just the assets and liabilities of one of the married [people], that is absolutely permissible. I have had people say, "If someone is married, you have to include their spouse." No, you can have the individual and, in today's day and age, this is something [we see a lot more].

When my father was practicing—and he is still practicing somewhat—but probably in the 1960s, he did not have to worry a whole lot. Some of his clients might have been divorced and maintained separate financial affairs, let's call it that. Nowadays, I see that a lot more, and it is not just because someone passed away and they remarried; it is because they went through a divorce, and we understand what the divorce rates are. I have many clients that are now very pleased with the person they are married to because they made a change. For various reasons they have decided, well, when I got remarried at 52, we are just going to keep our stuff separate. I never combine those; I will just take the one spouse that needs the service and put his or her assets and liabilities on the personal financial statement. Even though you can omit disclosures, and we will get into this later, that is the one thing that I would disclose, and make sure it is certain, and emphasize that these are just the assets and liabilities of the individual presented, not that person's spouse, because I think, sometimes, bankers just assume that it is both people.

Now, interestingly enough, personal financial statements can include an entire family unit if you define it. In other words, it can be a mother, a father, and four children. Let's say there are a lot of business ventures and, maybe, there has been a lot of gifting of stock over the years because of estate issues. So, they say, "These five or six people who are related own these entities, and they are the ones who are all going to have to sign personal endorsements on the debt of this entity." You can do it. I have not done many of these, but it is permissible to expand it.

What I have not seen and, based on my reading of the standards, is not permissible is [for example], I have two or three real good friends and we will go play golf. I don't think we can combine our assets and liabilities and say, "Here is our personal financial statement," because there is no family relationship there—even though I like them a lot better than some of the members of my family. (Hopefully, none of the members of my family will ever see this particular recording.) That is where there is a boundary, but it is not just limited to an individual or to married individuals; it can be expanded to a family.

Ms. Grove Casey

Let's talk about the statements that are available under GAAP because it is a little bit different than what we normally think of for a corporate-type entity.

Mr. Oestrieher

Right. The main one and, quite frankly, sometimes the only statement issued is going to be the statement of financial condition, which is the equivalent of the balance sheet. In most lending cases, that is what they are looking for. If they want to have an idea of the income, that is when they use tax returns and other source data. We will talk about a statement of changes in net worth later on; that is the equivalent of the income statement.

The statement of financial condition is, by far, the focal point, if you will. Assets and liabilities are going to be presented in the order of liquidity and maturity. There is no current and non-current classification, so that is why things like retirement accounts, if it is a 35-year-old, I would list the retirement account as the last of the things that are liquid. Even though I am probably going to sell my house before I cash in on my retirement, I am still going to list the retirement [before the house] because it is more liquid. If I had to, I could go tomorrow and cash in my retirement account (unfortunately, I would pay a lot of taxes and a penalty because I am still under 59½), but the house would take a little bit longer. So, there is some subjectivity but, generally, the liquid items are listed first, in order of maturity or when you expect to have access to those funds.

Then, you look at the non-liquid assets, such as closely held businesses, your residence, land, things like that. The business interests that I just mentioned, of all the things that are contained in a personal financial statement, that one, in my opinion, has the most subjectivity. What is a business worth? Real estate, [such as] residences, there is comparable stuff sold next door or in your neighborhood. But when you are talking about either commercial real estate or active businesses, a lot of that commercial real estate value is going to be based on rental income and future prospects of rental, and that is an extraordinarily subjective measure. That is why you are going to show those separately. You are not going to just list wholly owned companies or partially owned companies or something, and then just put a number, because of the fact that there is some subjectivity there.

Again, if you are not omitting disclosures—we are going to talk about disclosures later on—there are more specific disclosures on ownership. In fact, for my own personal financial statement, the items that I have (you can guess, if I am a partner in CPA firm, I own some businesses), I put stock in Oestriecheer and Company Limited, but then show my ownership percentage on the face of my statement of financial position. We have a real estate building and a couple of other real estate items, so you should show your ownership there.

We don't separately include the assets and liabilities of the business. For Oestriecheer and Company CPAs, if you look at that balance sheet, I am not going to show 50 percent of the receivables, and 50 percent of the cash, and 50 percent of the liabilities. I just say, this is the value of Oestriecheer and Company, net, and put it in there. If, in the disclosures, I want to show summary information of those closely held businesses, that is fine. The reason people generally don't do that is the bank also has the company financials; they have all the data that they need on the company.

So, closely held businesses are, by far, the most subjective item out there. I actually talked to a banker recently about that and he said, "We use our independent analysis of that. We know you have to put it on there." What they are focusing on is the value of cash, retirement accounts, and debt. Those are the things that they can pretty accurately determine what is the estimated current value. They use their own methodology for some of these other items.

Ms. Grove Casey

Let's talk a little bit about general issues that arise and that kind of thing.

Mr. Oestriecheer

First of all, and it states this specifically in the guidance, you use the accrual basis of accounting. So, getting back to your statement of financial condition, if I am preparing a December 31 personal financial statement for, let's say, a married couple, and I prepared their tax return, and I know that they owe \$118,000 in federal and state taxes, that is a liability. They may not be paying it until April 15, but that is a liability. Conversely, a refund is on there.

Generally, we think of that as potentially the only accrual, but it is not. Let's say that there is an oil interest. You look at the tax return (because that is really a great source of information for my clients for personal financial statements) to see where they stand or what their income or revenue sources are, and assets and liabilities. I see that they have \$120,000 of oil royalties from one particular asset. Well, common sense tells you that there has been some oil drilled in December, that they are not going to get the check until January or February, and it could be a material amount. This also goes to your statement of changes in net worth. We didn't hit on that a whole lot, but that is—you have heard "the other white meat" (it is an old slogan)—well, the statement of changes in net worth is the "other financial statement" that we don't see very often. Then, that would be accrued as a revenue source.

You could also have, maybe, a year-end bonus that has been earned from this person's employment that gets awarded in January. If we know what the bonus is, it can be calculated. Quite often they may have already received it. Then, that is accrued as a receivable on the statement of financial condition, and as revenue on the statement of changes in net worth.

So, it is accrual basis; that is the first thing people need to understand. There are some jurisdictions where property taxes are assessed and paid on June 30 instead of December 31. While it is very common to have personal financial statements as of the end of the year, if you are halfway through a year (and you are in one of these areas) and you have a \$28,000 property tax bill due in June, then we need to accrue \$14,000 of that. So, it is not cash basis, it is

accrual basis. That is the first thing that we need to understand in determining what is presented. [In other words] what do we recognize on either the statement of financial condition or the statement of changes in net worth?

Now, how do you measure these items? When you are looking at GAAP for businesses, we know that the concepts in the approach to fair value has changed over the years. (We actually used to call it fair market value.) Can we determine that? Well, markets aren't the only way to determine fair value—these are what we refer to as Level 3 inputs. For Level 1 and Level 2 inputs, there are observable market conditions; Level 3 is unobservable. We actually no longer even use the term *fair market value*; we use the term *fair value*. Interestingly, Accounting Standards Codification 274 still kept the definition that was in the AICPA guidance that says assets should be stated at *estimated current values*, and liabilities are going to be at *estimated current amounts*. In other words, what is the dollar amount it would take to settle that liability on the date of the statement of financial condition?

Generally, this is very easy for liabilities. If I owe some amount on my car, on my house, or a banknote, how much would it cost to settle it that day, including any accrued interest and including any prepayment penalties? We need to remember that those are the items that would be accrued in there. What would settle it that day (many times, we don't have those prepayment penalties), and putting in that dollar amount.

The assets are at estimated current values. When you look at the definition, and they have the definition in there (and I am going to read it verbatim to make sure that I get it right), but this has always been my definition of fair value, or fair market value, or estimated current value—all these things that are intended to convey what is something worth. [Estimated current value] is defined as “the amount at which an item would be exchanged between a buyer and a seller, each of whom is well informed and willing, and neither of whom is com[pelled] to buy or sell.” That definition is so extraordinarily objective. Notice it doesn't say appraised value or doesn't say most recent purchase price, or comparable, or anything else.

Every time I have negotiated to purchase something, I start out at a different number than the person that I want to buy it from and, vice versa, if I am selling something, I always start out with a different number. Sometimes, we come to a number in the middle; sometimes, we do not. I was looking at trading in a couple of vehicles and getting another one and they sent me a trade-in value of what they would give, and I laughed and emailed them back and said, “We are too far off. Don't even email me back,” and they didn't, and so we just walked away. So, that transaction didn't happen and that is okay, but I still know what I think those items are worth, and that is what is important.

We disclose these items, and that is why I wanted to mention (earlier) that conversation I had with the banker. When they get into these things, such as the value of your closely held business, it all depends on the time of the year. On April 2, I am probably more willing to sell my business for a whole lot less money than I would be willing to sell it for in October, let's say, after I have gotten through tax season and all of our audits. I probably would have sold this bad boy for about \$20 on April 3 this year and just been able to walk away, as long as I get to keep the receivables for all the work that I had done. So, there are so many factors that go into this and it is extraordinarily subjective, but that is the definition. That is what we are going to live with. We are going to talk about the different levels of service we can provide, but we need to understand that it is not a concrete amount, and that we also don't use the criteria that we have for fair value (that we have for other types of entities other than personal financial statements) in U.S. GAAP.

Ms. Grove Casey

Liabilities, you said, are done at estimated current amounts, correct?

Mr. Oestrieher

Correct, so that is not a fair-value thing. It isn't an assumption that, I owe this person \$120,000; I think I can go negotiate it down to \$80,000 because they are desperate for money. No, it is the actual amount to settle without any negotiations—\$120,000 plus accrued interest. That is what you would have to report as the liability. The liabilities are actually much easier to pin down because there is, usually, some sort of empirical evidence or agreement as to what the settlement amount is as of a certain date for that liability.

Now, when you get into some derivative-type transactions it could be a little bit harder but, fortunately, most individuals don't have material derivatives (even though, embedded within their investment accounts, they could

absolutely have some options and stuff). That is a tricky amount. I have some clients that know which direction they believe Tesla stock or Apple or anybody's [stock] is going to go, but that is why—even though it is not required when we compile financial statements—we get a rep letter on these things, because I don't know if they maybe spent \$100,000 on options to purchase a stock, and now those options are worthless, or if it is even better than just an option. If you think you are smarter than everybody else when it comes to the value of oil, and now you are sitting there holding a derivative that, if it is settled that day, because you thought oil was going to go one direction and it went the other, and now you have an \$85,000 liability, that [liability] needs to go in your personal financial statement. Most people, even the clients themselves, don't understand that is a liability, that is the settlement amount on that day, because you own an interest in a financial transaction and you got on the wrong side of it. That is the lesson, boys and girls: don't do trading unless you really, really know what you are doing because, generally, the person that is on the other side of the bet has more information than a regular Joe like you and me.

Ms. Grove Casey

Yes, and I think it applies to precious metals, as well. Let's talk about something that is on that right-hand side of the balance sheet (if we had two sides as opposed to just a single statement) that a lot of times people forget about, and that is the provision for income taxes—probably the biggest liability amount sitting there, actually.

Mr. Oestrieher

Absolutely. Because we show items at estimated current values, if we were to liquidate them on the date of the statement of financial position, there would be taxes due, in most cases. The biggest one, of course, is the retirement account. That is why I [completely] agree with you that estimated taxes are usually the biggest liability when you get to people who have been around as long as you and I have, who have been working as long as you and I have and have wisely put money in a 401(k) or a Roth or something like that. We will go traditional 401(k) for this example. There is no basis in that, and if you are under 59½, there is a 10-percent penalty; if it is a Roth, it is a 25-percent penalty.

All of that has to be taken into account. [I may say] "I feel good about myself—I have a \$2.7-million net worth," but if I were to liquidate all this and turn it into cash on this date, sorry, the government would want a check for a \$1 million, so I really only have a \$1.7-million net worth (or whatever that number might be).

By the way, this number is not on the American Banking Association's (ABA) pre-printed form that the banks often hand to our clients and, the way the standards are written right now for prescribed forms, that is a departure from GAAP. So, we actually have to modify our compilation report to show that that departure exists because there is now an assumption (our guidance for prescribed forms is now in the *AICPA Preparation, Compilation and Review Engagements Guide*, and there is an underlying assumption) that everything is measured at GAAP. I really wish they would change that. I have talked to the folks at the AICPA and maybe, someday, they will. I would love to go back to where there is an assumption that the prescribed form only wanted the stuff that is on the prescribed form, that it wasn't everything that is required by GAAP, but that is not where we are right now.

So, a bank could get a much different perspective of an individual, whether or not a CPA prepares something on plain paper in accordance with U.S. GAAP and includes this provision for taxes, versus the prescribed form that doesn't have that item in there. So, make sure you calculate it properly, but you have to have knowledge of the tax basis of all their assets. Of course, if they meet the exclusion, if they are under the limits for the one-time exclusion for the residence [that factors into the calculation], because a lot of times your 401(k) is not the largest asset, someone's residence is the largest asset (if they don't own a closely held business), and that usually is a very large dollar amount.

[Having this knowledge is also important for] closely held businesses. In Louisiana, if you were to sell that business, it used to be a 100-percent exclusion for Louisiana tax; I want to say it is 85 percent now. You have to know, what are the applicable taxes? Or, is this business in a state that charges taxes on those types of things? So, there is some tax knowledge that has to be brought in on this provision for income taxes. Of course, you can omit it, but then you have to disclose the GAAP departure. But I think it is a valuable number because [for] the person whose financial statement is being presented, it gives him or her a better understanding of, where am I, really, financially? How much of this does the government get?

Ms. Grove Casey

Just like with business entities, it is not all about the measurements and the statements. Let's talk about the disclosures.

Mr. Oestricher

Remember, if you are compiling, you can omit disclosures. Management can do that. I am going to go back to the ABA statement. After they have the statement of financial condition, you notice how they have all these forms about any other debt you have, any other debt that you are signed on, life insurance policies, all that? Well, that is their disclosures, and if you don't have a pre-printed form GAAP says there are some very important disclosures—and not just where you are and what is presented. There are other aspects of a person's personal financial situation that are useful to a decision-maker and they start that out with, first of all, what entity is presented? Is it an individual, a married couple, or a group of families we talked about? You have to disclose that assets are presented at estimated current values and, if you are using some valuation models for things such as closely held businesses, you would want to disclose the methodology used.

A lot of people use capitalization of earnings, EBITDA; CPA firms for example, a lot of people use gross revenues as a base, and then they adjust it for items. So, there are all sorts of different ways to value it. But understand, like between my partners and I, we have a certain methodology for valuing our shares should someone exit the business, and it is different if they exit before what we consider to be our retirement age, if they exit for death or disability, or if we decide to sell to another company. (Forget about that—if another CPA firm wants to buy us, we are going to start a bidding war, we hope, and get the highest value, more than what, maybe, we would have paid for the shares ourselves.)

So, what model did you use? A lot of times, for closely held businesses, you will use these internal valuations because that is most likely, in my situation, what I will wind up getting for this company. There is no intention for us to sell to another CPA firm; the intention is the younger partners are going to buy me out, so that is the methodology that I use in determining the fair value, even though it is a lower amount than if I go on the open market.

If there are jointly held assets, that doesn't just mean the people presented. My father and I own some businesses together. He has his personal financial statement with mom, I have my personal financial statement with my wife. My dad and I own not only this firm but some other items, so we would disclose what is my ownership percentage, and I go ahead and disclose by the way, who is the other owner.

I [may] have investment portfolios that have major concentrations (we have talked in this series over the years of how U.S. GAAP has various concentrations). What if I am one of these people who says, "The only thing is gold and silver. You better have all your investments in gold and silver." People don't realize you can't eat gold and silver and it is a commodity, like anything else, but it is an investment. Well, I am going to disclose that the majority of these investments were in precious metals. [Some people say], "You only invest in oil and gas companies." Those are concentrations. If you are in the S&P 500 index fund, you don't have a concentration; you are well diversified.

[Disclose] as much information as possible on your closely held business to allow the reader to understand. In other words, what is the ownership percentage? Are there mandatory buyout clauses? Mandatory retirement ages? Again, I am going to use something near and dear to my heart, CPA firms or law firms. Many of them have [clauses] that at 65, you have to get bought out.

Any relevant information (and even pro forma information). Total assets, net income from the previous year, would be the types of things you would have. In the rare events you have intangible assets, maybe you developed a patent or something that is not in an LLC or a closely held business, you would want to disclose that. The face amount of life insurance owned and the type of policy (obviously, whole life versus term), the expiration dates of those terms, all that would be important. Any non-forfeitable rights, such as pensions. So, if I am in Louisiana and my wife is a teacher (she worked for a parochial school, but if she worked for public schools), she can't go ask for her share of the money, but she can certainly disclose that at a certain age she could get a certain amount of this, the estimated amount, and that she would have it for life. Or we may choose the option that I would get half of it should she [precede] me. All that is very, very important information. Of course, one of the most important things you have is

social security. Most of us have that, and anyone can get a social security statement and say that, right now, your projected benefits when you retire are X amount, and that is a non-forfeitable right in a pension, should you have it.

Tax disclosure—we have talked a lot about taxes. What jurisdictions are you subject to? What methodology did you use to come up with your estimated current taxes? For all the debt that you have (this is very similar to what you have in for-profit businesses), what is your monthly payment? When does it mature? Are there balloon payments? Are there variable interest rates? (That is becoming more and more [common] in today's environment; variable interest rates are definitely in play.) Any non-cancelable commitments. If you have a commitment to purchase a partner out, or have a commitment to purchase anything in the near future, you would want to disclose those because that would be a cash out.

Ms. Grove Casey

We have talked about the statements and what kind of entities are involved. Let's talk about what we can do, as CPAs, in terms of the engagement.

Mr. Oestrieher

Well, you can do anything: you can audit, review, compile, or prepare. My go-to is compilation because, again, I want the report on there. Because personal financial statements are a little bit squirrely, for lack of a better term, I want a report on there. I typically will (or the client will) omit all those disclosures but, sometimes, the banks say, "No, we want the disclosures." So, if you put in the disclosures, I would always get a rep letter. I get a rep letter on all of my personal financial statements anyway because I want to make sure that management, or owners (the people) give me a representation that they have included all of their assets and all their liabilities and they used reasonable methods for their fair value. Certainly, [it is] not required; it is just something a CPA firm may want to do. But if there are disclosures included, now I am more worried about disclosures that are omitted that they should have told me about, so I am going to get that on the rep letter.

So, do the compilation. I mentioned the prescribed form earlier. If you are filling out the ABA, you can't just put in the numbers and give it back to the client because you have now prepared, and you are engaged to prepare, the financial statements; that puts you under SSARS. You can either use the prescribed form report that is in the guide or you don't have to use the prescribed form report, you can just sit there and use a typical compilation report. Of course, if you do the preparation, you don't have to include the report. I caution against it.

I can't imagine a situation where I would accept an engagement to review or audit personal financial statements, even though you absolutely can. There is additional guidance now on auditing estimates and fair value, because that is the big challenge that we have there. But again, I guess just auditing something that doesn't start with a trial balance gives me the heebie-jeebies—and that is a very technical term there, "heebie-jeebies"—so I have never done it, but you can do it. Don't buy into the myth that you are only allowed to compile personal financial statements. You can audit or review, but get a really big fee if you are going to do that, and make sure you have a good insurance policy.

Ms. Grove Casey

Any other final thoughts?

Mr. Oestrieher

Just remember the context of a personal financial statement. I have never heard of a situation where a personal financial statement was the key piece of data or the only thing that is going to be looked at by the third party that requests it. It is a part. Even if it is just the individual who wants a personal financial statement so he or she (or the couple, together) can do personal financial planning. It is just a starting point and it is never the end-all, like sometimes financial statements for regular businesses are. Understand that context, have knowledge of the standards, and have knowledge of the limitations of the personal financial statement. Choose the compilation—again, I want to re-emphasize that—and now you are providing a very valuable service to your client, and any third party, at a very effective cost for your client.

SUPPLEMENTAL MATERIALS

Personal Financial Statements

by Kurt Oestrieher, CPA

Introduction

Personal financial statements have long been used by lenders, advisors and others to evaluate the financial status of an individual for family for a myriad of purposes. The underlying standards originated in an AICPA Statement of Position, and when the GAAP Codification was adopted, the guidance in the Statement of Position was codified in ASC Section 274. This course will provide updates on the proper measurement and presentation for personal financial statements.

Reporting Entity

The reporting entity can be an individual or married couple (note that the guidance in the FASB Codification has not been updated to include same sex marriage). It is the opinion of the author that this is an oversight and that the definition of married couples in ASC 274, which is defined as “husband and wife”, should not be interpreted to eliminate same sex married couples from reporting both persons financial information in a single personal financial statement. A family can also be the reporting entity, though this type of entity is rarely used in financial reporting.

Financial Statements

Statement of Financial Condition

The primary measurement for assets and liabilities that are reported on the Statement of Financial Condition is estimated current value. While this is similar to fair value, the same definitions and conventions used to determine fair value for business and not-for-profit entities are not applied to estimated current value. Estimated current value is defined as:

“Estimated current value 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”

While this definition will many times yield the same results as applying the definition of fair value, a reporting entity is not required to present all of the disclosures required for fair value since that term is not used in personal financial statements. As an example, if a business entity and an individual each owned stock in a publicly traded company that was worth \$150,000 on December 31, 20XX, both would report that value on their respective financial statements. However, the business would also have to disclose that this is a Level 1 fair value measurement and all of the other information required for fair value disclosures. The personal financial statement is not required to have such disclosures since estimated current value instead of fair value is used to determine the value of the asset.

All of the assets of the reporting entity shall be presented at fair value and in the order of liquidity and maturity. Typically, cash accounts and unqualified investments will be presented first, followed by qualified investments such as IRAs and the vested portion of 401K accounts. After highly liquid assets are presented, real property such as rental property, land, and a personal residence are then listed.

Ownership interests in closely-held companies are sometimes listed after real estate due to the fact that a person will often sell real estate before selling a closely-held company that is the primary source of income. If a business interest is a large portion of the total assets, the asset should be presented separately on the face of the Statement of Financial Condition and not “lumped together” with other financial investments.

Automobiles, personal property such as boat and recreational vehicles, along with home furnishings are often the last items listed.

Determining estimated current values can be time consuming, and in some cases, costly. Some of the more common sources of estimated current value for various assets are listed below.

| Asset | Estimated Current Value Source |
|-------------------------------------|---|
| Residence | Comparable real estate listing Recent appraisal |
| Investment Real Estate | Comparable real estate listing Recent appraisal EBITDA capitalization |
| Closely-held company | Book value Book value adjusted for fair value of assets and liabilities Business valuation EBITDA capitalization <i>Note – the separate assets and liabilities of the closely-held company should not be reported on the Statement of Financial Condition</i> |
| Jewelry and furnishings | Cost (if purchased recently) Appraisal Reasonable insurance coverage Online resources |
| Automobiles, RV's Boats | NADA value Other online resources |
| Life insurance policies | Cash value |
| Future value of retirement benefits | Items such as Social Security and payments from defined benefit plans are not allowed to be presented as an estimate of future benefits because those amounts are not available to the individual on demand as of the date of the financial statement |

Liabilities are typically presented at the amount necessary to settle the debt and will usually not present any measurement difficulties. If material pre-payment penalties are due upon settlement of the debt, then the amount of penalty paid should be added to the debt. Ultimately, the Statement of Financial Condition is designed to indicate the amount of cash that would be available to the reporting entity if all assets were liquidated and liabilities paid as of the date of the Statement of Financial Condition.

In the event that the reporting individual has an interest in a joint venture, only the portion of the joint venture owned by the reporting individual should be included. If there is debt associated with the joint venture, only the portion of the debt that is allocable to the reporting individual should be included. However, if the reporting individual is an obligor on the entire amount of the debt, that fact should be disclosed. If current facts and circumstances indicate the individual will likely have to pay the entire debt, such as bankruptcy of the other parties, consideration should be given to listing the entire amount of the debt as a liability.

The Statement of Financial Condition should include a provision for current federal or state taxes payable. If the date of the financial statement is December 31, the amount of refund or payable on the tax returns should be used. If the financial statements are an interim date, an estimate of the taxes receivable or payable should be calculated and presented.

Assets and liabilities should not be classified as current and non-current, but instead listed in order of liquidity.

An “estimated taxes on differences between estimated current value and the tax basis” should be calculated and presented after the total liabilities. This calculation is necessary in order to continue the overall objective of the personal financial statement of indicating the cash available to the reporting individual in the event of liquidation of all assets and settlement of liabilities as of a specific date. The following factors should be considered when calculating this tax estimate:

- Expected ordinary tax rates should be used for bonuses receivable or any other asset that would be considered ordinary income if received as of the date of the Statement of Financial Condition. The most common assets that would be ordinary income is a distribution from a retirement account and certain depreciation recapture.
- Capital gain rates should be used for all assets that are subject to capital gains.
- Alternative minimum tax should be considered if the taxpayer is either typically subject to alternative minimum tax or the liquidation of all assets would increase income to now trigger the alternative minimum tax.
- The net investment income tax should be considered for capital gains if the taxpayer is above or would be above the NIIT threshold on liquidation.
- If the taxpayer is under age 59 1/2, the early distribution penalty should be calculated for retirement distributions unless an exception would apply. Penalties related to early distribution of Roth accounts should also be considered.

Net worth is calculated as the residual of assets less liabilities and estimated taxes on the differences between estimated current value and tax basis.

The following is an example of a Statement of Financial Condition.

James and Jane Person

Statement of Financial Condition

12/31/20XX

Assets

| | |
|-------------------------------------|---------------------|
| Cash | \$ 145,000 |
| Mutual funds | 50,000 |
| Retirement plans | 1,200,000 |
| Stock - Company ABC - 50% ownership | 500,000 |
| Land LLC, Partnership (50%) | 250,000 |
| Investment, LLC (50%) | 250,000 |
| Residence | 450,000 |
| Recreational vehicle | 250,000 |
| Vehicles | 80,000 |
| Total assets | <u>\$ 3,175,000</u> |

Liabilities and Net Worth

| | |
|------------------------|----------------|
| Income taxes payable | \$ 2,000 |
| Mortgage payable | 150,000 |
| Note payable - vehicle | 10,200 |
| Note payable - vehicle | 51,500 |
| Note payable RV | 85,000 |
| Total liabilities | <u>296,700</u> |

Estimated taxes on the differences between the estimated
current value of assets and the estimated current values of
liabilities and their tax bases

780,000

| | |
|---------------------------------|---------------------|
| Net worth | <u>2,098,300</u> |
| Total liabilities and net worth | <u>\$ 3,175,000</u> |

Statement of Changes in Net Worth

A statement of changes in net worth is usually not presented as most users of personal financial statements are more concerned with net worth. Other documents such as income tax returns or financial statements of closely held business are used to provide relevant information related to income. From a practical standpoint, most people do not maintain sufficient detail of personal financial transactions throughout the year, therefore, obtaining the information can be costly. The sections of the Statement of Changes in Net Worth are as follows:

Realized increases in net worth

The reporting entity will include all income received in the form of cash or other liquidating compensation. Common elements of this section include:

- Salary and other forms of income from employment
- Investment income – dividends and interest
- Distributions from closely held investments
- Gains on sales of assets

Realized decreases in net worth

- Personal expenditures
- Income and real estate taxes
- Interest expense

Unrealized increases in net worth

- Unrealized gains on marketable equity and debt securities
- Decrease in estimated taxes on estimated current values of assets and liabilities
- Increases in qualified retirement accounts
- Other increases in estimated current values of assets or liabilities

Unrealized decreases in net worth

- Increase in estimated taxes on estimated current value of assets and liabilities
- Unrealized losses on gains in marketable equity and debt securities
- Decreases in qualified retirement accounts
- Other decreases in estimated current values of assets or liabilities

In order to properly prepare a statement of changes in net worth, all realized transactions should be recorded in a general ledger using the broad categories suggested above. Journal entries should be used to adjust assets and liabilities to fair values. The entries will typically be presented in the unrealized increases and unrealized decreases section of the financial statement.

Disclosures

ASC 274 provides guidance on disclosures for personal financial statements. While many personal financial statements will be presented in the form of compiled financial statements that omit substantially all disclosures, the following disclosures should be presented on audited, reviewed, or other presentations that do not omit substantially all disclosures.

- The entity for which the financial information is presented
- Accounting policy that assets and liabilities are measured at estimated current value

- Methods used in determining the estimated current value of major assets and any changes to such methods
- Nature and ownership percentage of jointly held assets
- Major concentrations of investment portfolios
- Relevant information for closely held investments
- Description of any intangible assets and the estimated useful life
- Face amount of life insurance owned
- Nonforfeitable rights such as pensions
- Methods used for determining the estimated taxes, both current and estimated taxes on differences between estimated current value and tax bases
- Unused operating losses, capital gains losses, and other suspended losses
- Maturities of debt, interest rate and collateral
- Noncancellable commitments

While not required, the face of the financial statements will often contain cross-references to any footnote disclosure that provides information related to that asset or liability. For example, if a mortgage obligation is on the Statement of Financial Condition, and note reference such as (Note X) may be placed on the line item for the mortgage obligation to alert the user to the additional disclosure.

Levels of service provide by a CPA

AICPA standards permit the issuance of audit, review, or compilation reports with respect to a personal financial statement. An accountant may also perform a preparation engagement with respect to a personal financial statement. All ethics requirements, including independence, must be adhered to in the performance of any engagement. Therefore, any relative of the CPA should be evaluated to determine if an independence impairment exists. If there is an impairment, an audit or review engagement is prohibited. A compilation may be performed, but the lack of independence must be disclosed.

Audits

While it is permissible to perform an audit, many firms will not perform such an engagement. The completion assertion creates a high inherent risk as most individuals do not maintain a set of books. There is also high inherent risk on many of the assets that are presented at estimated current value.

Reviews

Because review procedures are substantially less in scope than an audit, this is the preferred engagement when a user requires some level of assurance. An accountant would rely much more on inquiries as there are not many analytical procedures that would provide review evidence other than a comparison with prior periods.

Compilations

Compilations are by far the most common engagement, and for many firms the only type of engagement, performed on personal financial statements. The accountant uses the same standards, AR-C 80, that are used in a compilation of financial statements for a for-profit, not-for-profit, or governmental entity. Therefore, an engagement letter is required and other compilation procedures are required.

Summary

CPAs in public practice are often able to assist clients in preparing and presenting personal financial statements for banking, borrowing, and other purposes. The CPA should be familiar with how to present the personal financial statements in accordance with GAAP and choose the appropriate level of reporting based on the needs of the client and user.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss how assets are presented in the Statement of Financial Condition in a personal financial statement presentation.
2. Discuss the four sections included in the Statement of Changes in Net Worth in a personal financial statement presentation.
3. Discuss the disclosures that may need to be in a personal financial statement presentation.

B. Suggested Answers to Discussion Problems

1. All of the assets of the reporting entity shall be presented at fair value and in the order of liquidity and maturity. Typically, cash accounts and unqualified investments will be presented first, followed by qualified investments such as IRAs and the vested portion of 401K accounts. After highly liquid assets are presented, real property such as rental property, land, and a personal residence are then listed.

Ownership interests in closely-held companies are sometimes listed after real estate due to the fact that a person will often sell real estate before selling a closely-held company that is the primary source of income. If a business interest is a large portion of the total assets, the asset should be presented separately on the face of the Statement of Financial Condition and not “lumped together” with other financial investments.

Automobiles, personal property such as boat and recreational vehicles, along with home furnishings are often the last items listed.

2. The four sections of the Statement of changes in net worth include the following:

Realized increases in net worth

The reporting entity will include all income received in the form of cash or other liquidating compensation. Common elements of this section include:

- Salary and other forms of income from employment
- Investment income – dividends and interest
- Distributions from closely held investments
- Gains on sales of assets

Realized decreases in net worth

- Personal expenditures
- Income and real estate taxes
- Interest expense

Unrealized increases in net worth

- Unrealized gains on marketable equity and debt securities
- Decrease in estimated taxes on estimated current values of assets and liabilities
- Increases in qualified retirement accounts
- Other increases in estimated current values of assets or liabilities

Unrealized decreases in net worth

- Increase in estimated taxes on estimated current value of assets and liabilities
- Unrealized losses on gains in marketable equity and debt securities
- Decreases in qualified retirement accounts
- Other decreases in estimated current values of assets or liabilities

3. ASC 274 provides guidance on disclosures for personal financial statements. While many personal financial statements will be presented in the form of compiled financial statements that omit substantially all disclosures, the following disclosures should be presented on audited, reviewed, or other presentations that do not omit substantially all disclosures.
- The entity for which the financial information is presented
 - Accounting policy that assets and liabilities are measured at estimated current value
 - Methods used in determining the estimated current value of major assets and any changes to such methods
 - Nature and ownership percentage of jointly held assets
 - Major concentrations of investment portfolios
 - Relevant information for closely held investments
 - Description of any intangible assets and the estimated useful life
 - Face amount of life insurance owned
 - Nonforfeitable rights such as pensions
 - Methods used for determining the estimated taxes, both current and estimated taxes on differences between estimated current value and tax bases
 - Unused operating losses, capital gains losses, and other suspended losses
 - Maturities of debt, interest rate and collateral
 - Noncancellable commitments

PART 2. AUDITING

Nonaudit Attestation Options

Accounting professionals may provide a variety of attest services with the audit being at the highest level of assurance. An audit provides reasonable assurance. Additionally, providers may perform review services for limited assurance or compilation services, which result in no assurance, but is an attest engagement. Other attest services include examinations and agreed-upon procedures.

For more on the types of nonaudit attestations services available, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk about the nonaudit attestations options and when do the different types of engagements apply. In general, let's talk about what are attest services and why do CPAs perform them.

Ms. Louis

Attest services can really cover [either] financial or nonfinancial matters, just depending on the needs of a user of a report. What happens in an attest service is that the auditors do evaluate a subject matter or an assertion, but it has to be compared to some sort of specific criteria. So, as we think about these attest services, it is something where if I have this case where I'm evaluating things that—often to say something's attest, it's stipulated that sometimes only a CPA is the one that can offer these types of protected services. What's laid out as far as what can be done by a CPA is guided by the various state boards of accountancy and determining when you have to be a licensed CPA or CPA firm to do certain levels of these types of services.

Ms. Grove Casey

How do assurance services relate to attest services?

Ms. Louis

Attest, ultimately, can be a service such as a compilation where I'm not providing any assurance, but yet there's a report that's created that says I looked at this information, I read it, and I did this work in conformance with a set of professional standards. So attest and assurance, as we think about them, they really are slightly different as we think about creating a report and think about providing assurance. Because there can be scenarios where no actual assurance is being provided, even though I'm generating some sort of report. The goal of assurance-type services is to give readers more confidence as it relates to the subject matter as we're forming an opinion or a conclusion or reporting an outcome in some way.

Ms. Grove Casey

How do audits categorically fit into the various assurance options?

Ms. Louis

Well, audits deal with, principally, historical financial statements. It's the highest level of assurance that you can give to financial statement users as I give an opinion about whether or not these financials were fairly presented in all material respects in accordance with a given framework. So, in the end, the CPA is giving reasonable assurance. They're giving an opinion related to these financial statements, and it's going to be based on a variety of procedures that they perform as it relates to inquiry, analytics, but also physical inspection of certain assets, and maybe sending confirmations, and other actions that they deem necessary in order to support this opinion.

Ms. Grove Casey

We want to focus today on the nonaudit service options. What are some examples of nonaudit services that may provide comfort or assurance on financial and nonfinancial subject matters?

Ms. Louis

You're finding a lot of cases where it's not just an audit of the financial statements that is the desired level of service. It may be that a given party that might be asking for some sort of attest—they may be comfortable with a review. They may be comfortable with agreed-upon procedures. Where I'm doing things that are not the highest form of engagement, but yet I'm giving you some level of comfort.

There also can be cases where no assurance is being provided, but yet I'm associating myself with some sort of subject matter. Where I might be preparing the financial information and just say "I'm preparing it, but no assurance is provided." As I mentioned, the compilation engagement—there's no assurance, but there's an actual report, where a preparation engagement doesn't have a report.

There can be attest not just on historical information—like historical financial statements that are audited. I might examine, which is like an audit, but it's a subject matter other than historical financial statements. I might be looking at prospective financial information or pro forma financial information or examining compliance with some sort of specified requirement.

As we think about all the options of things that are out there—some assurance based, some not; some focused on historical information, some based on other subject matters—but they wanted, within the professional standards, to give practitioners a full complement of service offerings that could help meet the needs of an engaging party.

Ms. Grove Casey

Talk to me more about letters of comfort. What standards are those engagements performed under?

Ms. Louis

Oftentimes, particularly in smaller-entity-type environments, a practitioner might get a phone call from the bank or an insurance company, and they're asking for a comfort letter. It's a nonattest service. It's not a report, right? It's not something where I'm giving an opinion or assurance, and so it is a nonattest service. A comfort letter is not a report that's prepared underneath our SSARS, SAs, [or] SSAEs—those don't exist. Now, I am, in essence, in this communication, I am verifying some factual information. So, I'm not asserting information. I'm not giving an opinion. I'm not asserting that something's fairly presented, but I am maybe stating a fact that could be communicated in some written form to these requesting parties under appropriate circumstances.

Ms. Grove Casey

Can you tell me more about the inherent limitations and what can be the subject matter of a comfort letter?

Ms. Louis

In no case whatsoever, regardless of whether it's an audit or anything, [can you] provide any form of assurance on matters that relate to solvency or the financial presentation of matters relating to solvency. I can give you information, and the reader can look at that information and form their own conclusions about solvency. "Will the company be able to pay me back if I loan them this money?" The practitioner is precluded from giving any form of assurance that says, "Yes, I think they're going to be able to pay you." I can give you information, and you can make that decision, but I'm not going to tell you what your decision should be.

In addition, when we talk about a comfort letter, it is something that, first of all, you have to have the client's consent to respond because we have client confidentiality provisions within our code of professional conduct. And it has to only be factual information.

So, I may be able to provide a copy of the tax return that I prepared, and I can say, "Hey, I can give you a copy of the tax return that I prepared with the client's written consent." Right? But I can't give any type of conclusion or assurance about the tax return. I'm just providing a copy of something.

If the requesting party desires some form of assurance related to the matters, and then they need to think about, “Well, what other form of engagement can I engage you for that might meet my needs? Where I am able to get some sort of report that can meet my intended purpose?” We can’t just respond to requests without thinking about, “Is there another form of engagement that really would be better for us to comply with as I’m trying to ensure that I am managing my professional liability risk in the circumstances?”

Ms. Grove Casey

What makes a preparation of financial information different?

Ms. Louis

As we think about preparing financial information, as I mentioned, as we think about preparing a tax return, I can give a copy of a tax return to a requesting party with the client’s permission. I also can prepare income tax basis financial statements with or without disclosures that also could be used to give to intending parties. It’s not intended to give assurance, as we think about preparing financial information. It’s simply to prepare historical, prospective, [or] pro forma information without providing assurance. As I mentioned, because we’re not providing assurance, you can either have footnotes or not have footnotes or have select information, but there’s no actual report. I’m just preparing this financial information, and it’s going to say on it, “No assurance is provided.” And that information can be shared by the engaging party. They can share it with whoever they want, but they’re agreeing in the context of this engagement that we’re going to make sure that the no assurance statement is put in place on this information because I’m now associated with these financials as being engaged to prepare them. But preparation engagements are completed underneath our Statements on [Standards for] Accounting and Review Services, the SSARS. It is the only nonattest, nonreporting option that is included within our professional standards itself.

Ms. Grove Casey

How is a compilation engagement different than a preparation of financial information engagement?

Ms. Louis

The main difference is that there is a report. It still can cover the same subject matters. You’re still not giving assurance. I can still omit disclosures or not omit disclosures. What’s different is that there’s an actual report that has to have these minimum elements in it to communicate matters such as this is no assurance provided, and are there disclosures or not, and what’s the framework that’s being applied. The other thing that would be different is that you do have to state in a compilation report if the CPA lacks independence. I can still do the engagement if I’m not independent, but I have to tell people that I’m not independent. But it’ll allow for me to still do that engagement because I’m not giving any assurance. So, it’s not a huge deal that I’m not independent in the eyes of various users. But the main thing between a prep and a comp is the fact that I do have this report where there are mandated elements of things that have to be included in this report as opposed to the nonreporting option of the preparation engagement.

Ms. Grove Casey

Reviews are both attestation and assurance engagements. What professional standards are they performed under?

Ms. Louis

Well, it’s going to depend on the subject matter. If it’s looking at historical financial statements, then you do use your SSARS, your Statements on [Standards for] Accounting and Review Services. If it’s looking at pro forma financial statements and other subject matters, then you are looking at your Statements on Standards for Attestation Engagements or your SSAEs. In both cases, you’re only providing limited assurance that no material modifications need to be made to this subject matter in order for [it] to be in accordance with some stipulated criteria. So, there are these reviews that can be done underneath these matters.

Now, if it’s not historical financial statements, there are some subject matters under the SSAEs where reviews are not permitted. I can’t review prospective financial information, or review internal controls, or review compliance with laws and regulations. I can review pro forma information, but not some of these other subject matters. If I need assurance on some of these other subject matters, I would have to do an examination or agreed-upon procedures for those subject matters.

Ms. Grove Casey

When would an examination engagement be appropriate to meet the client's needs?

Ms. Louis

As mentioned earlier, an examination is like an audit. It's most like an audit. It's just that I'm looking at a subject matter other than your historical financial statements. It's looking at prospective financial statements, pro forma financial statements, compliance [with] laws and regulations. I'm giving reasonable assurance. I'm giving an opinion about the conformity of a subject matter against some stipulated specified criteria. So, it is most like an audit to do an examination.

Ms. Grove Casey

Aren't there different types of examination engagement options available now?

Ms. Louis

Yes, you're right, there are, because of SSAE No. 21. They permitted there to be two types. One is that a party that's responsible for the subject matter makes an assertion about the subject matter. That means that they've gone through and measured and evaluated the subject matter against criteria first so that they can provide an assertion about what they think the outcome is. Second is a *direct examination* where the practitioner is the one that goes through and measures and evaluates the underlying subject matter against the criteria without having the assertion from the responsible party. Within the SSAEs, it talks about, you know, that this direct examination engagement was created to provide more flexibility for practitioners to do things like examining the calculation for greenhouse gas emissions. That could be a direct examination.

But they (the ARSC) do presume that there's some subject matters that really need to be assertion based. Like if I'm reporting on an examination of controls for a service organization to create an SOC report, that needs to be an assertion-based examination. If you're going to examine compliance with a law, or a regulation, or a contract, or an agreement—like, a stipulated thing—the responsible party should have examined their compliance with those things first before the practitioner comes in. Certain subject matters would lend themselves to say it really should be that an assertion is available on these matters.

Then there are cases where there's subject matters that aren't in that realm that really do lead themselves to potentially being a direct examination. As long as the practitioner is comfortable accepting the direct examination, understanding how the report's going to be used, and why is it that the responsible party isn't going to give me an assertion about the subject matter in advance of me doing the work?

Ms. Grove Casey

What's the objective of an agreed-upon procedures engagement?

Ms. Louis

Agreed-upon procedures [are] also done underneath the SSAEs. All I'm doing at this point is performing procedures that an engaging party told me to do and reporting my results. I'm not applying judgment. I'm not giving an opinion. I'm not forming a conclusion. The engaging party says, "Do X, Y, Z," and I just go and do it and tell them what I found. So, it's the engaging party that is responsible for the sufficiency of the procedures.

Agreed-upon procedures can be done on a variety of subject matters. It can be historical financial statements [or] prospective financial information. It can be on compliance with laws and regulations, like compliance with debt covenants. There are a variety of subject matters [for which] agreed-upon procedures would be appropriate if they don't want a full-blown examination and a review is not an option.

Ms. Grove Casey

Are there any subject matter restrictions when performing engagements under attestation standards?

Ms. Louis

It does have to be that the practitioner is comfortable that the subject matter is appropriate, meaning that there is, in existence, a reasonable basis for measuring or evaluating this subject matter. Obviously, that's going to depend on the nature of the subject matter. It does need to be that a subject matter is identifiable and it is capable of being consistently measured or evaluated against some applicable criteria, so I know that there's something I can pair against as I provide my findings, my opinion, [and] my conclusion. There does need to be criteria that are suitable and available as we think about objective, measurable, complete, and relevant criteria as we look at the presentation of this information. Competent people using [the] same or similar criteria should be able to come up with similar outcomes.

Ms. Grove Casey

Can you talk more about what makes the criteria suitable for attestation purposes?

Ms. Louis

It could be that it's criteria that is created by a regulatory agency, a body of experts, [or] an industry association. There's something that maybe was specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter. So, when I talked about the greenhouse gas emission rates earlier, it could be that I compare it against the formula that is recommended by the Environmental Protection Agency, the EPA. The EPA has a formula; I could say, "Are they calculating their rates in conformance with this formula that is recommended as a best practice from this federal agency?"

Ms. Grove Casey

Are there any restrictions on who can engage a CPA to perform an attestation engagement?

Ms. Louis

There [are] not restrictions on who can engage me. Now, sometimes the engaging party is different than the party that's responsible for the subject matter of the engagement. In those cases, we have to make sure that we are independent of the responsible party. As we think about who, really, [the] independence rules should apply to—well, who's responsible for the subject matter?

And then, within the attestation standards, there [are] guidelines on making sure that I'm having the proper communications with the engaging party [and] with the responsible party. Depending on the nature of the engagement, there'll be different rules around how much. Particularly, how much interaction should I be having with the responsible party? Obviously, there's going to be mandated interaction with the engaging party because that's who's hiring me, but then there are some differences in thinking about the responsible party.

Ms. Grove Casey

What are the various ways in which a responsible party can assume responsibility for the subject matter subject to attestation?

Ms. Louis

Even if I don't have to get a written assertion from the responsible party, if I don't have to get a [representation] letter from the responsible party, those are ways in which they could acknowledge that we are accountable for the subject matter. It could be through a written assertion or written representation letter. It could be through an engagement letter, but it also could be that they're just presenting the subject matter to me. As they present it and hand me the subject matter, I can now go and do my procedures on that subject matter.

In some cases, I may not be able to get a formal acknowledgement from the responsible party, but there may be other ways that I can determine that, yes, this is the party that's responsible for this subject matter. And that might be through reference to a law, regulation, contract, or agreement in some form.

Ms. Grove Casey

When is the written assertion required to be obtained by the practitioner in order to perform an attestation engagement?

Ms. Louis

The written assertion from the responsible party, as we look at the SSAEs, it is when I do a review and when I do an assertion-based examination. If I'm doing a direct examination or an agreed-upon procedures [engagement], I'm not required to get a written assertion from the responsible party in order for me to do those services, but there are going to be designated things that I have to [do to] interact with the engaging party.

Ms. Grove Casey

What happens if the responsible party refuses or is otherwise unable to provide a written assertion to the practitioner?

Ms. Louis

If we're in that situation—like the review or the assertion-based examination—that's where it becomes a problem because that's when it was required for me to get it and I can't get it. Part of that's going to depend on is the responsible party also the engaging party? If it's also the engaging party and they're refusing to give this written assertion, then you can't do the engagement.

But if the responsible party is different than the engaging party and the responsible party is refusing to cooperate, then I could withdraw. Or I could issue the report to the engaging party, disclose the fact that I didn't get any type of assertions or anything from the responsible party, and I would restrict the use of that report to the engaging party so that they can use it for their intended purposes. But we're not intending this to be a general-use thing without that written assertion.

Ms. Grove Casey

What are some important factors to consider when evaluating the appropriateness of a written assertion for attestation purposes?

Ms. Louis

An example of an assertion could be something like the fact that the aged trial balance of accounts receivable as of a given date accurately ages my outstanding invoices in my AR subsidiary ledger as of that date. That can just be an example of an assertion. Then I can come in and test that in order for me to form an opinion or a conclusion.

It could be that [the assertion] says the number of widgets that are sold by a company during a given time period was calculated in conformance with a stipulated agreement between two different companies. That's an assertion that could be made and something that we can go and perform procedures against. It's important that it is something, though, that we believe the subject matter to be appropriate and that there is suitable objective criteria that we can compare against if we're looking to provide assurance on those matters.

Ms. Grove Casey

How is a written representation letter different from a written assertion?

Ms. Louis

The written representation letter is required for the engaging party as we are looking at these different engagements—agreed-upon procedures, reviews, [and] examinations underneath the SSAEs; also reviews underneath the SSARS. But also, if we think about the responsible party that might be different than the engaging party, there also would be representations that would be required in a review and [an] examination from that responsible party. As we're having them assert certain things to us at the end of an engagement, that's important related to the subject matter of that engagement.

Ms. Grove Casey

What if either the engaging party or responsible party refuses or otherwise is unable to provide a written representation letter?

Ms. Louis

Now, we're talking about not just, "Here's the assertion," but "Here's representations I'm making." Like, "I've told you everything you need to know," and other types of things like that. So, it is important that if [an] engaging party refuses to give a written representation letter, then I should walk away. Then I've got a management-imposed scope limitation on this engagement, and I shouldn't be doing that engagement.

There may be cases in some situations where we can note the refusal as a scope limitation. But it is important, as we are looking at the circumstances, particularly from an engaging party, that why is it that they aren't wanting to put these things in some sort of written form? If the responsible party is not the engaging party, though, there is some flexibility with reviews and assertion-based engagements in some cases to still be able to issue a restricted-use report to the engaging party.

Ms. Grove Casey

How do audit concepts generally apply to attestation engagements?

Ms. Louis

When we think about materiality, it's going to be the same as we think about reviews and examinations, as we're forming an opinion or conclusion. But also in an examination, they're going to apply a lot of the similar concepts—like there's going to be [an] assessment of inherent risk, and control risk, and detection risk, and they'll see a lot of parallels between audits and examinations. As far as reviews, a review underneath the SSARS and a review underneath the SSAEs will also have a lot of parallels to them.

Ms. Grove Casey

Does the Code of Professional Conduct apply to attestation engagements?

Ms. Louis

The Code of Professional Conduct applies to any type of services that we're providing as it relates to CPAs. I have to make sure that I'm complying with our ethical principles of being competent and doing things with due professional care. Now, independence will kick in as you're giving assurance—reviews, examinations, [and] agreed-upon procedures. They all need to have independence. Whereas, in other situations—like a prep or a comp-type engagement—I only need to make sure that I'm objective and free of conflicts of interest when I'm doing those types of engagements.

Ms. Grove Casey

Are there any specific responsibilities with obtaining an understanding with the client about an attestation engagement? Is a written engagement letter required?

Ms. Louis

Any time you're doing any engagement underneath the SSARS, the SASs, [or] the SSAEs, you're going to start having a written engagement letter. Now, each of the different types of services will have minimum requirements of what it is that they're looking for in those engagement letters, but all of them will require a written engagement letter.

Ms. Grove Casey

Are there any other preconditions that have to be met prior to accepting or continuing with an attestation engagement that you want to highlight?

Ms. Louis

I think, ultimately, we always want, in any engagement, to make sure that, do I think I'm going to be able to get adequate evidence to meet the objective of this engagement? Access to information, access to people, right? Those things that should also be as we think about engagement acceptance/continuance decisions—that any engagement should be thoughtfully thought about as we look at the compliance of our code of professional conduct that governs everything that we do.

SUPPLEMENTAL MATERIALS

Nonaudit Attestation Options—When Different Engagements Apply

by Jennifer F. Louis, CPA

Overview

Attest (or attestation) services can cover a broad range of financial or nonfinancial objectives based on the users' needs. Auditors evaluate subject matter or an assertion in accordance with specific criteria. Attest engagements include assurance and non-assurance services. Most importantly, attest services are a set of protected services that *only* licensed certified public accountants (CPA) who operate within a CPA firm can perform.

Licensed CPAs have the right degree of expertise, education, and regulatory oversight to conduct attest engagements following standards issued by the American Institute of Certified Public Accountants (AICPA). CPAs must be independent on all attest engagements.

In addition, they're required to participate in ongoing education requirements and peer review efforts and comply with a professional code of conduct. Each of these factors ensures that the CPA profession is appropriately regulated and CPAs deliver high-quality services.

Assurance services fall within the larger category of attest services. When providing assurance services, a CPA issues a report that expresses a conclusion or opinion on the subject matter. The goal of an assurance service is to enhance decision-makers' confidence in specific information, such as financial statements or security controls. Therefore, CPAs perform procedures to test the credibility of information. These procedures may include inquiries, observations, or more detailed testing.

Audits provide the highest level of assurance. The purpose of an audit is to provide financial statement users with an opinion on whether the financial statements are presented fairly, in all material respects, according to the applicable reporting framework. Financial statement audits are subject to generally accepted auditing standards (GAAS) issued by the AICPA or another set of professional standards (such as those set by the PCAOB or the IAASB).

During an audit, CPAs perform procedures to obtain *reasonable assurance* that financial statements are free from material misstatement. The auditor may conduct physical inspections, make inquiries, request third-party confirmations, make observations, and take other actions they deem necessary to obtain this assurance.

Once procedures are complete, CPAs will issue a formal report letter attached to the financial statements. The report expresses an opinion on whether the information is presented fairly in accordance with the applicable financial reporting framework. CPAs must also issue a separate report on any internal control deficiencies they discover that rise to the level of a significant deficiency or material weakness.

Many companies need an audit when applying for financing or credit, looking for outside investors, or preparing to sell or merge. The auditor's report gives each party more confidence in the accuracy of the information and allows them to make a more informed decision.

In the past few years, attestation services have grown in popularity as the need for an independent party to provide assurance over topics other than financial statements has become required by laws, regulators, or service clients. This segment will include the basic definition, standards, and examples of common attestation services.

The following are example engagements that may be performed on subject matters other than historical financial information:

1. *Letters of comfort or preparation of financial information* that are not associated with any attest service (i.e., there is no report with a conclusion, opinion, or any form of conclusion);
2. *Compilation* engagements that do not provide assurance, but result in a report.

3. *Examination, review, or agreed-upon procedures* on a subject matter or written assertion thereto about the subject matter's conformity with specified criteria (e.g., fair value of an asset on a certain date, capital accounts, description of square footage of space, backlog data, etc.);
4. Examination, review, or compilation of *pro forma financial information* (i.e., how historical financial information would have looked had a specific transaction or event occurred at an earlier date);
5. Examination, compilation, or agreed-upon procedures on *prospective financial information* (e.g., sales forecasts or cash flow projections); or
6. Examination or agreed-upon procedures related to *compliance with specified requirements* (i.e., compliance with laws, regulations, contracts, or agreements when a financial statement audit is not also engaged).

Letters of comfort

Nonattest services do not result in any report, subjective conclusion, opinion, or assurance.

Generally, nonattest services are governed by the AICPA's *Code of Professional Conduct*, but not any other specific professional technical standards (e.g., the SSARs, SAs, or SSAEs), except for section 70, *Preparation of Financial Statements*, under the Statements on Accounting and Review Services (SSARS), which is a nonattest service.

Letters providing verification or other forms of comfort to lenders, regulators, and others stating specific factual information (not "asserting" information) are deemed nonattest services.

In all cases, in *any* engagement form, a practitioner is precluded from providing any form of assurance on matters relating to solvency or any financial presentation of matters relating to solvency.

CPAs are not precluded (with the client's written consent) from providing lenders with responses based on factual information (e.g., a statement that the CPA has prepared financial statements or a tax return) in certain situations. In some cases, a third party's original request for "comfort" may not be able to be complied with. However, a suitable alternative in the form of an attest or nonattest engagement may meet the third party's needs.

The CPA may corroborate third party requested information by performing additional procedures, where the results are communicated in some form of attest report. These engagements may be performed in accordance with the appropriate sections of Statements on Standards for Accounting and Review Services (SSARSs) or Statements on Standards for Attestation Engagements (SSAEs).

Preparation of Financial Information

Preparation of financial statement services is often intended for the owner's use to have the information needed to know the financial standing of the business and to make business decisions accordingly. The following are key points about preparation engagements:

1. The objective is simply to prepare either prospective, historical, or pro forma financial statements pursuant to a specified financial reporting framework.
2. Preparation of financial statement engagements may also cover specified elements, accounts, or line items of a financial statement, supplementary information, or required supplementary information.
3. Reporting entity management may elect to substantially omit all disclosures in prepared financial statements.
4. The financial statements may be shared with third parties.
5. No report is issued, and independence is not required to be evaluated since this is a nonattest service.

Compilations

Compilations are performed in accordance with Statements on Accounting and Review Services (SSARS). The following are key points related to compilation engagements:

1. The objective is to apply accounting and financial reporting expertise to assist management in the presentation of *prospective*, historical, or *pro forma* financial information in conformance with an applicable financial reporting framework.
2. Engagements may also cover specified elements, accounts, or lines of a financial statement, supplementary information, required supplementary information, or financial information contained in a tax return.
3. Reporting entity management may elect to substantially omit all disclosures in compiled financial statements or financial information.
4. The CPA does not obtain or provide any assurance that there are not material modifications that should be made to the financial statements.
5. The CPA is not required to be independent, but the CPA is required to indicate any lack of independence in the compilation report.

An attestation engagement may be part of a larger engagement. For example, a feasibility study or business acquisition study that also includes an examination of prospective financial information. The attestation standards only apply to the attestation portion of that engagement.

Reviews

Reviews of *historical* financial statements are performed in accordance with Statements on Accounting and Review Services (SSARS). A review may also encompass specified elements, accounts, or lines of a financial statement, supplementary information, required supplementary information, or financial information contained in a tax return.

Reviews of *pro forma* financial statements and other subject matters are performed in accordance with Statements on Standards for Attestation Engagements (SSAEs). The objective is to obtain limited assurance that there are no material modifications that should be made to the subject matter in order for it to be in accordance with (or based on) the criteria. Reviews are not permissible for prospective financial information, internal control, or compliance with requirements of specified laws, regulations, rules, contracts, or grants.

Evidence is primarily obtained through the performance of inquiry and analytical procedures. Independence is required to perform this attest service.

Examinations

Examinations are performed in accordance with Statements on Standards for Attestation Engagements (SSAEs). Examinations may be performed on *prospective* or *pro forma* financial statements, or in other situations where *subject matter (or an assertion thereon) can be evaluated against suitable criteria*. In addition, a CPA may be engaged to perform an examination on *compliance* with specified compliance requirements (e.g., compliance with debt covenants or other laws regulations, contracts, or agreements).

An examination results in a reasonable assurance opinion about the conformity of the measurement and evaluation of subject matter against specified criteria, or that an assertion thereon is fairly stated. The CPA obtains a high, but not absolute, level of assurance. Independence is required to perform this service.

SSAE No. 21 permits either assertion-based examinations or direct examinations.

1. *Assertion-based examination engagement* – A party other than the practitioner measures or evaluates the underlying subject matter against the criteria and provides an assertion about the outcome of the measurement or evaluation.

2. *Direct examination engagement* – The practitioner measures or evaluates the underlying subject matter against the criteria *and* performs other procedures to obtain sufficient appropriate evidence to express an opinion. The responsible party does not provide an assertion.

SSAE No. 21 stipulates that the requirements of AT-C Section 205 for assertion-based engagements apply to direct examination engagements, except as stipulated otherwise in AT-C Section 206.

- There may be a requirement that cannot be applied as written because of the nature of the direct examination engagement, in which case the practitioner should adapt and apply the requirement.
- Specific requirements in AT-C Section 206 address accepting or continuing the engagement, terms of the engagement, required written representations, and required report elements.

SSAE No. 21 states that the option to perform a direct examination is *not* applicable to the following subject matters, where an assertion-based examination would be most appropriate:

- AT-C Section 305, Prospective Financial Information
- AT-C Section 310, Reporting on Pro-Forma Financial Information
- AT-C Section 315, Compliance Attestation
- AT-C Section 320, Reporting on Examination of Controls at a Service Organization Relevant to User Entities' Internal Control Over Financial Reporting
- AT-C Section 395, Management's Discussion and Analysis

Before accepting or continuing a direct examination engagement, the practitioner should obtain an understanding of the following with appropriate parties:

- The intended purpose of the engagement, how the report will be used, and why the engaging party wishes to engage the practitioner to perform a direct examination engagement.
- If the responsible party has not measured or evaluated the underlying subject matter against the criteria, why the responsible party has not done so (e.g., lack of personnel or systems).
- If the responsible party has measured or evaluated the underlying subject matter against the criteria, why the responsible party does not intend to provide an assertion (e.g., only a partial assessment was performed).

Agreed-Upon Procedures

Agreed-upon procedures engagements are performed in accordance with Statements on Standards for Attestation Engagements (SSAEs). The following are key points related to agreed-upon procedures engagements:

- The objective is to perform procedures specified by an engaging party and to report the findings without providing any opinion or conclusion.
- The engaging party is responsible for the sufficiency of the procedures for their purpose.
- Agreed-upon procedures may be performed on either prospective or historical financial statements.
- In addition, a CPA may be engaged to perform agreed-upon procedures on compliance with specified compliance requirements (e.g., compliance with debt covenants or other laws regulations, contracts, or agreements).
- Independence is required to perform this service.

Subject Matter Considerations

The subject matter must be appropriate as a precondition for engagement acceptance. An element of appropriateness is the existence of a reasonable basis for measuring or evaluating the subject matter. What constitutes a reasonable basis will depend on the nature of the subject matter and other engagement circumstances.

An appropriate subject matter is identifiable and capable of consistent measurement or evaluation against the applicable criteria and can be subjected to procedures for obtaining sufficient appropriate evidence to support an opinion, conclusion, or findings, as appropriate.

The subject matter (or assertion thereon) must be capable of evaluation against criteria that are suitable and available to users. Suitable criteria are objective, measurable, complete, and relevant—and should be clearly described in the presentation of financial information. Competent persons using the same or similar criteria ordinarily should be able to obtain materially similar estimates or measurements.

However, competent persons will not always reach the *same* conclusions because:

- Measurements often require exercise of considerable professional judgment.
- A slightly different evaluation of the facts could yield a significant difference.
- Therefore, for the same subject matter there can be different suitable criteria, which will yield different measurement or evaluation.

The following is example guidance related to deeming criteria to be "suitable":

1. Criteria promulgated by a body designated by Council under the AICPA *Code of Professional Conduct* is considered suitable criteria by definition.
2. Criteria issued by regulatory agencies and other bodies of experts that follow transparent due-process procedures are also considered suitable.
3. Criteria issued by industry associations or other groups should be critically examined for suitability.
4. Criteria that is specifically designed for the purpose of measuring, evaluating, or disclosing the subject matter or assertion in the particular circumstances of the engagement.
5. Criteria developed for sale on a proprietary basis.
6. Criteria published in scholarly journals or books.

Responsible Party Considerations

An engaging party and the responsible party may be different. The CPA is required to identify the responsible party and ensure whether the party takes responsibility for the underlying subject matter as a prerequisite for accepting any attest engagements. It is important that a practitioner can name the responsible person or persons, either as individuals or representatives of the entity, responsible for the underlying subject matter (or has a reasonable basis for providing a written assertion about the subject matter). When the engaging party is different than the responsible party, the CPA may still be able to accept such an engagement if the CPA is able to obtain evidence of a third party's responsibility for the underlying subject matter (or written assertion thereon).

A practitioner may be engaged to gather information to enable the responsible party to evaluate the subject matter in connection with providing a written assertion. Because of the CPA's attest role, the CPA may not assume the role of the responsible party in an attest engagement. Regardless of the procedures performed by the practitioner, the responsible party must accept responsibility for the underlying subject matter.

The responsible party can acknowledge that responsibility in several ways, including:

1. An engagement letter.
2. A representation letter.
3. The presentation of the subject matter, such as through narrative description or schedule.
4. A written assertion.

If the CPA is *not* able to obtain direct written acknowledgment because the client is not the responsible party, the CPA should obtain other evidence of the responsible party's responsibility for the subject matter (e.g., by reference to legislation, regulation, or contract).

When Written Assertions are Required

The practitioner is explicitly *required* to obtain a written assertion about the measurement or evaluation of the subject matter against the applicable criteria from the responsible party for **assertion-based examination** and **review** engagements. SSAE No. 21 does *not* require the practitioner to request a written assertion from the responsible party when reporting directly on the subject matter in a **direct examination**.

In an **agreed-upon procedures** engagement under SSAE No. 19, a written assertion from the responsible party is *not* required. However, written representations are requested from the engaging party, and appropriate steps must be taken if the representations are not provided or not reliable.

Example assertions include:

- The aged trial balance of accounts receivable as of DATE, accurately ages outstanding invoices in the accounts receivable sub-ledger as of that date.
- The number of widgets sold by ABC Company during DATE RANGE was calculated in conformance with AGREEMENT dated DATE between ABC Company and XYZ Company.

The following are important considerations when the responsible party refuses or is otherwise unable to provide the required written assertion for **assertion-based examination** and **review** engagements:

1. When the responsible party (who *is also* the engaging party) refuses to provide a written assertion, the practitioner is required to withdraw (when possible, under applicable laws and regulations).
2. When the responsible party (who *is not* also the engaging party) refuses to provide a written assertion, the practitioner need not withdraw, but is required to disclose that refusal in a report restricted to the use of the engaging party.

The exception to these rules is when the attestation engagement relates to **prospective** or **pro forma financial information**, where a refusal by the responsible party (whether the engaging party or not) requires withdrawal from the engagement (when possible, under applicable law or regulation).

The following are important concepts related to the written assertion:

1. Language needs to be tailored to the circumstances, for example:
 - Subject matter is presented in accordance with (or based on) the criteria.
 - Subject matter achieved the objectives when the objectives themselves are criteria.
 - Subject matter is presented fairly, based on criteria.
2. Written representations may serve dual-purpose of written assertions.
3. The practitioner may be engaged to *assist* the responsible party with measuring or evaluating the subject matter against the criteria, but the responsible party must ultimately accept responsibility for the assertion and the subject matter.

Written Representation Letter Required

The practitioner is *required* to obtain representation letters from the responsible party (and engaging party, if different) for **all examination** and **review** engagements. The practitioner is *required* to obtain a written representation letter from the engaging party for an **agreed-upon procedures** engagement.

1. The letter should address the subject matter and periods covered by the report and be dated the same day as the report.
2. When appropriate written representations are unable to be obtained from the *engaging party*, then withdrawal may be required.
 - As an alternative in an **assertion-based examination** engagement, the report may be modified to note that refusal as a scope limitation.
3. If a written representation letter is not able to be obtained from the *responsible party who is not the engaging party*, oral representations may be deemed adequate, and the report is restricted in use to the engaging party for an **assertion-based examination** or **review**.

These “exceptions to this rule” do not apply to prospective financial information, pro forma financial information, and compliance attestation engagements, in which written representations are always required.

Incorporation of Audit Concepts

The guidance for planning and performing **examination** and **review** engagements incorporates attestation risk concepts contained in financial statement audits. Particularly for **examinations**, which provide an opinion like an audit, the process for identifying and responding to assessed risks of material misstatement is clarified. This includes:

- A more in-depth understanding of the development and preparation of the subject matter in order to better identify risk.
- This includes evaluating the design of controls relevant to the subject matter and determining whether they have been implemented.

The goal is to lead to improved linkage between assessed risks and the nature, timing, and extent of attestation procedures performed in response to those risks (which may include tests of controls for operating effectiveness).

Ethical Responsibilities

The following quality control questions should be asked prior to accepting or continuing an attest engagement:

1. Does the CPA performing the attest engagement have adequate technical training and proficiency in the attest function?
2. Does the engagement team and any external specialist's collectively have the appropriate competence and capabilities to perform the engagement?
3. Does the CPA have adequate knowledge about the subject matter or related assertion thereon that is being reported on?
4. If a specialist is used, does the CPA have enough knowledge of the subject matter and the specialist to enable the engagement team partner to be responsible for the work of the practitioner's specialist?
5. Are the CPAs independent in accordance with the *Code Professional Conduct* and other relevant ethical requirements?

If the CPA is not independent but is required by law or regulation to perform an examination of the subject matter or an assertion, the CPA should disclaim an opinion and specifically state that the CPA is not independent. The CPA is neither required nor precluded from giving a reason.

For agreed-upon procedures in the same scenario, the report should specifically state that the practitioner is not independent. If reasons for lack of independence are provided, then all reasons need to be provided.

Engagement Letter Key Points

An understanding with the client as to the services to be performed must be reached in an engagement letter or suitable form of written agreement. The elements of understanding should include the following important details:

- The objective and scope of the engagement, including the standards to be followed. The report elements of "what you did" can be modified to describe "what you will do" for agreed-upon procedures engagements.
- Identification of the underlying subject matter or the assertion(s) thereon, which will be the subject of the report.
- Identification of the applicable criteria to be used for measurement, evaluation, or disclosure of the subject matter. In an agreed-upon procedures engagement this is accomplished by enumerating or referring to the procedures agreed to.
- Identification of specified parties, if relevant because of a restricted use report.
- The responsibilities of the responsible party (including for the underlying subject matter) and the responsibilities of the engaging party, if different.
- In an agreed-upon procedures engagement, the procedures to be performed and the engaging parties' acknowledgement of their responsibility for the sufficiency of the procedures. Determine whether parties in addition to the engaging party will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.
- In an examination, a statement about the inherent limitations of an examination engagement.
- In a review, a statement that procedures performed vary in nature and timing from, and are substantially less in extent than, an examination, and, consequently, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed.
- Acknowledgment that the engaging party agrees to provide a representation letter at the end of the engagement, if applicable.
- CPA's responsibilities.
- Any disclaimers expected to be included in the report.
- Whether the engagement is being performed pursuant to any law, regulation, or content.
- Involvement of a practitioner's external specialist, if applicable.
- Agreed-upon materiality limits, if applicable in an agreed-upon procedures engagement.

Necessary Access Precondition for Any Engagement

The CPA should have access to the evidence needed to arrive at an opinion, conclusion or findings, including the following:

- Access to all information of which the responsible party is aware that is relevant to the measurement, evaluation, or disclosure of the subject matter (such as records and documentation).
- Access to additional information that the CPA may request from the responsible party for the purpose of the engagement.

Unrestricted access to persons within the appropriate party(ies) from whom the CPA deems necessary to obtain evidence.

GROUP STUDY MATERIALS

A. Discussion Problems

1. Discuss the examples of nonaudit services that may be performed for clients to help provide “comfort” or assurance.
2. Discuss the two types of examination engagements permitted under SSAE 21.
3. Discuss the elements that should be in an understanding related to an engagement.

B. Suggested Answers to Discussion Problems

1. The following are example engagements that may be performed on subject matters other than historical financial information:
 - Letters of comfort or preparation of financial information that are not associated with any attest service (i.e., there is no report with a conclusion, opinion, or any form of conclusion);
 - Compilation engagements that do not provide assurance, but result in a report;
 - Examination, review, or agreed-upon procedures on a subject matter or written assertion thereto about the subject matter's conformity with specified criteria (e.g., fair value of an asset on a certain date, capital accounts, description of square footage of space, backlog data, etc.);
 - Examination, review, or compilation of pro forma financial information (i.e., how historical financial information would have looked had a specific transaction or event occurred at an earlier date);
 - Examination, compilation, or agreed-upon procedures on prospective financial information (e.g., sales forecasts or cash flow projections); or
 - Examination or agreed-upon procedures related to compliance with specified requirements (i.e., compliance with laws, regulations, contracts, or agreements when a financial statement audit is not also engaged).
2. SSAE No. 21 permits either assertion-based examinations or direct examinations.
 - *Assertion-based examination engagement* – A party other than the practitioner measures or evaluates the underlying subject matter against the criteria and provides an assertion about the outcome of the measurement or evaluation.
 - *Direct examination engagement* – The practitioner measures or evaluates the underlying subject matter against the criteria *and* performs other procedures to obtain sufficient appropriate evidence to express an opinion. The responsible party does not provide an assertion.

SSAE No. 21 stipulates that the requirements of AT-C Section 205 for assertion-based engagements apply to direct examination engagements, except as stipulated otherwise in AT-C Section 206.

- There may be a requirement that cannot be applied as written because of the nature of the direct examination engagement, in which case the practitioner should adapt and apply the requirement.
 - Specific requirements in AT-C Section 206 address accepting or continuing the engagement, terms of the engagement, required written representations, and required report elements.
3. An understanding with the client as to the services to be performed must be reached in an engagement letter or suitable form of written agreement. The elements of understanding should include the following important details:
 - The objective and scope of the engagement, including the standards to be followed. The report elements of "what you did" can be modified to describe "what you will do" for agreed-upon procedures engagements.
 - Identification of the underlying subject matter or the assertion(s) thereon, which will be the subject of the report.

- Identification of the applicable criteria to be used for measurement, evaluation, or disclosure of the subject matter. In an agreed-upon procedures engagement this is accomplished by enumerating or referring to the procedures agreed to.
- Identification of specified parties, if relevant because of a restricted use report.
- The responsibilities of the responsible party (including for the underlying subject matter) and the responsibilities of the engaging party, if different.
- In an agreed-upon procedures engagement, the procedures to be performed and the engaging parties' acknowledgement of their responsibility for the sufficiency of the procedures. Determine whether parties in addition to the engaging party will be requested to agree to the procedures and acknowledge that the procedures performed are appropriate for their purposes.
- In an examination, a statement about the inherent limitations of an examination engagement.
- In a review, a statement that procedures performed vary in nature and timing from, and are substantially less in extent than, an examination, and, consequently, the level of assurance obtained in a review is substantially lower than the assurance that would have been obtained had an examination been performed.
- Acknowledgment that the engaging party agrees to provide a representation letter at the end of the engagement, if applicable.
- CPA's responsibilities.
- Any disclaimers expected to be included in the report.
- Whether the engagement is being performed pursuant to any law, regulation, or content.
- Involvement of a practitioner's external specialist, if applicable.
- Agreed-upon materiality limits, if applicable in an agreed-upon procedures engagement.

PART 3. SMALL BUSINESS

Risk Management

Business entities always face a variety of risks. Managing the risks to rewards that deliver more is the key to an enterprise's success strategy. Enterprise risk management is an entity-wide strategy to identify and plan for risks within, not just an organization's finances, but also its operations and objectives.

For more on risk management and the required financial statement disclosures, let's join Jennifer F. Louis, a CPA with Emergent Solutions Group, LLC, and CPE Network's Debi Grove Casey.

Ms. Grove Casey

Today we want to talk about risk management challenges that we are expecting in 2023. Risk management has really come into focus for a lot of people over the last couple of years. Why is risk management perceived to be critical for high-performing entities?

Ms. Louis

For any organization to thrive, it has to be able to be adaptable to the entity and the environment, which does constantly evolve and change, and can get more and more complex with different opportunities that are out there for an organization to engage in. Therefore, it is important, from a risk management point of view, to really look at striking the right balance between risk and reward.

Enterprise risk management, or ERM, is a term that you might hear about. ERM looks at things from a big-picture point of view for an organization, thinking about long-term strategies that might exist but, also, to look at things in a more detailed point of view as every level of an organization really does share responsibility for identifying, and evaluating, and responding to risks. It is not just management and governance; there is a more holistic approach that needs to be used to strengthen an overall effort for effective short-term and long-term viability of an organization.

Ms. Grove Casey

If we generally agree that risk management is an important activity, do all organizations have risk management processes in place? It would seem like they should.

Ms. Louis

Yes, you would think so. In 2022, the AICPA issued a report, the *Global State of Enterprise Risk Oversight*, and in that report, it said that only about a third of organizations have a complete ERM process in place. There may be things that they are doing here and there but there is not, in essence, an overall program that is comprehensive, thinking about all levels of the organization.

The AICPA, in looking at this said, in particular, accounting and finance professionals find themselves having to develop risk management strategies and handling risk exposure, but it is through the accounting/financial reporting side of things as they are trying to link the strategic operational strategies and what that means around these bigger-picture risks.

Ms. Grove Casey

What would you say is the biggest and most obvious threat in our current environment? Certainly, there are plenty of risks.

Ms. Louis

Yes, and I would think that most people would agree that this ongoing economic uncertainty is an obvious threat for all types of organizations—whether you are public or private, for-profit or not-for-profit. There is the sense of not just thinking about economy these days. Because we have such a global focus on things, you have to think about not just what is happening within the U.S., but what is happening in other areas of the world, with inflation and other factors like that.

We do need to think about inflation, we need to think about the volatility of interest rates, and how businesses might be burning their working capital. Is there a risk of recession that might put some cost-cutting pressures on CFOs and other accounting/finance individuals in trying to figure out how to adapt to that particular point of view?

Ms. Grove Casey

Given the level of economic uncertainty, how important are full and transparent risk and uncertainty disclosures in financial statements?

Ms. Louis

If we think about the role that an accounting/finance person might be playing as [they] are drafting your GAAP-basis financial statements, within Codification Topic 275, FASB has a section dealing with risks and uncertainties where the disclosures are meant to focus, primarily, on these risks and uncertainties that could significantly affect amounts that are actually reported in the financial statements or the footnotes.

Now, these risks, as we think about if [they] could affect my financial position or my disclosures, need to be in the near term. “Near-term functioning” is [defined as not to exceed] a year from the date of the financial statements—your balance sheet date. The goal is to have disclosures about these risks and uncertainties that could affect my financial statements in the near term, and there are a variety of areas that would be included in that, like use of estimates, vulnerabilities of concentrations of risk, the nature of the operations, and other factors.

Ms. Grove Casey

You mentioned near term. Are there any types of risks and uncertainties that are considered out of scope for expected risk and uncertainty disclosures? I would think, maybe, ones that are perceived to be beyond the near term.

Ms. Louis

Yes, and things that are proposed changes in government regulations. It is proposed; we don’t know what is actually going to happen. Proposed changes in accounting principles,[as well]. It hasn’t actually happened yet. Also, the possible effects of things like war, or an act of God, or sudden catastrophes. We are not meant to have a crystal ball. You are not meant to be predictive of things. There is what is reasonable, things where a financial statement user would say, “Okay, it is fair that this is reasonably knowable stuff,” that you could incorporate into those risk and uncertainty disclosures.

Ms. Grove Casey

What are some examples of what would be disclosed related to the nature of an entity’s operations or activities? Let’s talk about that.

Ms. Louis

If you have actually commenced an operation, if the financial statements include a description about your major products, your major services that you have (as far as the principal reason why you exist and what your operations are), if you thought about things that really contribute to the main reason why you exist, are we giving context?

This could include things like the locations in which you engage in those operations; that could be a factor. Also, if you have more than one business within an entity, then you do, perhaps, need to give some context about the relative importance of each of those different lines of businesses with assets, revenues, and earnings. Even with a nonprofit, there should be disclosures about the services that you are performing and what are the revenue sources for these services—the reason that you exist.

The disclosures related to this don’t necessarily have to be quantified, but some relativity of thinking about the major reason why you even are around, and giving context to that, is something that would be important.

Ms. Grove Casey

Are risk reduction techniques required to be disclosed?

Ms. Louis

Well, if we think about risk reduction techniques that might mitigate my losses, then I need to determine [that], ultimately. It is not necessarily required that I tell you I have insurance or other things, but it is certainly encouraged for you to talk about, “Here is the risk, and here are some of my risk management strategies that I can tell you about,” to give the fuller picture.

Ms. Grove Casey

What should an entity disclose related to significant estimates? Usually, assumptions come in as part of that.

Ms. Louis

Right. ASC 275 requires discussion of estimates based on what is known information (what is reasonably knowable to me) at the date the financial statements are issued or available to be issued. So, I have this date. Is it reasonably possible that this estimate is going to change in the near term, and the change could be material? Is it reasonably possible there could be a significant change in this estimate in the near term? The actual outcomes may end up being different.

They want to make sure you disclose the risk but, then, there also could be a loss contingency where it could be probable and reasonably estimated that some negative outcome could occur. We do need to think about Topic 450 that deals with loss contingencies, as well, and what would be the related disclosures there (that are separate and distinct from the fact that I have estimates that have uncertainty)? There could be another disclosure that is triggered because of the increased likelihood of that problem.

Ms. Grove Casey

Let’s talk about a few examples of significant estimates that may be particularly sensitive to change in the near term.

Ms. Louis

Some common ones would be something like if my inventory is subject to rapid technological obsolescence; it could be that there is some equipment that is in my PP&E that has been superseded with technology (technology risk). Technology changes and it makes things that I had previously not have the same value to them. It also could be things like valuation allowances for receivables: trade receivables, loans receivables. There could be litigation-related obligations that might exist.

There are a variety of areas on both the asset and the liability side that have some sensitivity to things [changing] in the near term. That could affect these estimates as I am making my best guess about how to account for and measure these areas on my financial statements.

Ms. Grove Casey

Let’s talk a little bit about vulnerabilities that may create those concentrations of risk for an entity. Sometimes they are geographic, I think, and then there are other times where you may have a credit risk concentration, or ones that are a customer-concentration kind of thing. I am interested in your thoughts on this.

Ms. Louis

Yes, there can be an entity that is exposed to risk of loss greater than if it would have done something else. As we think about diversifying where you have, for example, cash in excess of FDIC insurance limits, if you had diversified, your risk of loss would have been different. So, those are some of the things, as we think about concentrations, that are based on information that is reasonably knowable to management at the date the financial statements are issued or available to be issued.

[If] there is a concentration of risk that exists as of the date of the financial statements, the concentration does make the entity vulnerable, and it would [be] at least reasonably possible that these events could cause a severe near-term impact. They are still thinking about materiality; they are still thinking about near-term (typically one year from the date of the statements) in trying to figure out when I need to tell people qualitative information about these risks.

Ms. Grove Casey

Let's talk about severe impact and what that really means for an entity. It can't just be that we had to close our doors because of this one event.

Ms. Louis

Yes, it is meant to be that [the event] would have a significant, financially disruptive effect on the normal functioning of the organization. Really, when we talk about severe effect, they actually consider that almost to be a higher threshold than material. Severe, ultimately, is not necessarily catastrophic. It doesn't have to be catastrophic, but it is something that could significantly disrupt the normal functioning of this organization, and there would be a financial effect as we think about the financial statements. Is it important enough to merit telling the potential users of these financial statements? Ultimately, it is material but, also, it is so significant that it might disrupt the normal functioning of the organization.

So, some things may be material, but they might not be disruptive. That is where they want to make sure that you are finding, from a transparency [standpoint], what would be understandable and useful information to really designate these things that are your highest risks that exist.

Ms. Grove Casey

Can you give a few examples of what may be deemed a concentration of risk that merits possible disclosure in the financial statements?

Ms. Louis

Right, because it is not practical that we disclose every risk; that is not going to be practical or financially [feasible].

Ms. Grove Casey

The notes are already longer than the statements.

Ms. Louis

Yes, the notes are already crazy. Typically, you are going to have something that might relate to the concentrations, maybe, in the volume of work that you are doing with a particular customer or vendor or lender—or with a nonprofit, a particular grantor or contributor—such that if there was a loss in that relationship, it could have consequences on the functioning of the organization.

It also could be concentrations in a particular product line, or service, or fundraising event, and if that were to change, if there was a loss, say, in a patent protection or my ability to do the fundraising event, then that would have an effect on the near-term functioning of the organization. It could be concentrations on the availability of, say, the supply chain with labor and materials and other things that I need in order to run my operations. It could be a market or geographic area that I conduct my operations in, as there might be political forces or other things that might disrupt my functioning.

Those are examples of things that might be in that threshold of saying, "We have something that potentially would be significantly financially disruptive to the normal function of this organization if there were to be changes in those areas."

Ms. Grove Casey

If an entity discloses a concentration of risk and then the severe impact doesn't actually happen, does that imply that the disclosure should not, really, have ever been made?

Ms. Louis

No, not necessarily. It is not that you are thinking about [whether or not it ever] comes to fruition. The goal is just to disclose the risk, ultimately, because we are saying it is only reasonably possible that this would happen. We are not saying it is probable.

Ms. Grove Casey

Right, actual results may vary.

Ms. Louis

Actual outcomes may vary, but we are trying to, ultimately, just give a red flag, give a heads up to say, “Here are the things that it is reasonably possible can have a severe effect, and you should be aware as you are making your decisions based on these financial statements.”

Ms. Grove Casey

Let’s discuss something that is probably at the forefront of everyone’s mind. How important are the concentrations of risk as a result of an entity holding deposits in excess of FDIC insurance limits?

Ms. Louis

Yes, I think that most of us can reflect back on the date of March 10, 2023, where Silicon Valley Bank was closed by the California Department of Financial Protection and Innovation. So, immediately, all of these depositors who had money in the Silicon Valley Bank are [asking], “How do I get my money back?”

The FDIC was named receiver and immediately started figuring out how to facilitate the resolution of this sudden banking failure that existed. For every depositor, for every customer, they had to look at their own specific agreement to determine what was going to be covered by this FDIC insurance (or not). Where am I protected and where am I not protected? Also, to figure out to what degree am I protected, as the FDIC insurance limit currently is capped at \$250,000 per depositor within each insured bank. So, if I have deposits in more than one bank, then each of those deposits would be insured separately.

When you are thinking about [deposits] in excess of FDIC insurance, is that a significant vulnerability for this organization or not? As you think about that being something that could be a risk (that this bank could fail), [do] I have significantly more deposits than the cap that are at risk of being lost? I think that for a lot of organizations, it was a wake-up call for them to be involved in that scenario.

Ms. Grove Casey

How does the FDIC determine what is covered?

Ms. Louis

They do add up all of the single accounts owned by the same person or the same entity at the same bank, and that [total] is what is used to say, “Up to \$250,000, we are going to cover deposits that are received,” but it doesn’t cover investments—even if they were purchased at the insured bank. It doesn’t cover investments, but it does cover deposits, checking accounts, savings accounts, money market deposit accounts, certificates of deposit, and money orders. Those are things that would be covered by the FDIC insurance.

If I had stocks or bonds, or mutual funds, or safe deposit boxes (and the contents that are in the safe deposit box), and even if there are Treasury bills or notes backed by the U.S. government, they are not covered by the FDIC insurance.

Ms. Grove Casey

Let’s talk a little bit about how the ownership structure of a deposit account matters, because I think it is per depositor and not necessarily per account.

Ms. Louis

Yes, so when they have a bank customer that has multiple accounts, it is possible that [they] may qualify for more than one \$250,000 coverage if they are put in different ownership categories, assuming that the requirements of each of the different ownership categories are met. There are certain things that have to qualify for different ownership categories, things like a revocable trust account or an irrevocable trust account, or certain retirement accounts or joint accounts, or employee benefit accounts. Those are things where you do want to be aware of what are the rules as you are trying to diversify and figure out your risk management. You do need to understand the different ownership categories and where your deposits fit.

Ms. Grove Casey

Let's talk about the use of sweep accounts. Are they helpful in managing risk with deposit concentrations?

Ms. Louis

Yes, a lot of banking customers participate in the bank's sweep programs because it allows for me to have any excess cash swept into another account, or used to purchase shares in some sort of money market, mutual fund, or other similar investment security, in order to get a better return [on the excess cash, depending] on the circumstances.

The nature of sweep accounts, ultimately, might vary. Sometimes, the programs are established to have a target balance amount for the customer's deposit account, and sweep it in and out of that deposit account to maintain a target balance. Sometimes, it is geared around trying to target an investment return amount for the customer. Sometimes, the deposits with the banks are put in overnight purchases of securities and [they] buy an overnight financial instrument. They buy and then sell the security, and return the funds back to the customers' deposit accounts. So, there are a variety of ways that you can think about these swept funds.

What is important is that some swept funds are used by the bank to purchase assets (such as shares in some sort of money market mutual fund on behalf of the customer), and some swept funds are actually held by the bank in accounts that earn interest or other returns that are paid by the bank. So, ultimately, if it is money that is held by the bank, then these aren't holdings that belong to the customer, and the cash remains in a deposit account and will be a deposit subject to resolution with the FDIC. But if the funds are not deposits, then they don't belong to the bank's customer. Even if the bank made the share purchases as an agent of the customer, they are not deposits that would be resolved through the FDIC insurance process. So, you need to understand who is really considered the holder of the sweeps.

Ms. Grove Casey

Let's switch gears a little bit. One of the things that has recently—and by recently, I mean within the last ten years or so—come to the forefront of risk management by entities relates to ESG (that is environmental, social, and governance). Governance, obviously, has been an issue for a little longer than that, in terms of a focus, and it is not that we haven't had environmental regulations or laws, but as far as investors' concerns with them, and the reflection in the financial statements, it is a little bit more recent. Are ESG matters important to risk management in today's environment? It would seem to be.

Ms. Louis

Yes, absolutely, and if we think about the role that accounting and finance professionals play, there are changing regulatory requirements. There are new reporting standards that are pushing organizations toward making sure that accounting and finance is aware of these metrics, these measures, and these obligations that are being created because there could be a financial statement or disclosure effect, particularly as we think about laws, regulations, fines, penalties, and factors like that, but also risks and uncertainty disclosures related to climate and other factors.

Yes, I think governance, and I think climate change and, certainly, the social component [are important]—with diversity, equity, and inclusion being something that recently has come more to the forefront. Also, data security is a factor that is coming more to the forefront of figuring out, when I have financial statements, when I have annual reports, what should I be telling people about these factors?

Ms. Grove Casey

Let's talk about why ESG is an area of risk that should concern accounting and finance professionals—and it is not just because we have to be reporting it.

Ms. Louis

Right, yes. Certainly, you can see it on an international scale but, also, within the U.S. with the SEC getting involved, particularly as it relates to climate change disclosures. Determining whether or not there are certain disclosures (if you are in a public capital marketplace, you have certain minimum disclosures) and then, should certain organizations have actual assurance given that these disclosures are fairly presented in conformance with some certain stipulated criteria?

There are some things that internationally, and through the SEC, are becoming something that might be mandated, but even if you are not in that capital marketplace, you still need to think about how stakeholders (consumers of your products and services, employees, donors) might be asking for more information about the organization's values and these matters that come from ESG reporting.

What is critical to see is, with investing and other financial decisions, particularly as the younger generation becomes more predominant, will ESG reporting actually become more of a cornerstone of financial reporting?

Ms. Grove Casey

Let's talk about cybersecurity risk. Why is it crucial for CPAs to have a good understanding of cyber risk management?

Ms. Louis

I mentioned how data security certainly is more in the forefront as we become more and more automated, both in our accounting/financial reporting, but [also] in our operations and other factors. You can't avoid it. Certainly, whenever you have automation, there are going to be things that could occur with phishing and ransomware and hackers and other things, and it is essential, from a risk management strategy, for accounting and finance departments to be aware of these cyber threats—where to make investments in resources that will help mitigate the negative outcomes that could come from these cyber threats as you build it into your budgets and other factors, as well.

Ms. Grove Casey

What tips do you have for mitigating cyber risks if you are a CPA?

Ms. Louis

Even if we are just a CPA—a CPA firm or a sole practitioner as I think about who might be listening to this program—it is important. You have a lot of sensitive client information and, certainly, you need to think about your priorities and steps that are in place to increase your resiliency against some sort of hacking, some sort of ransomware, some sort of phishing scheme. It could be things like requiring automatic screen locking to reduce the opportunity of unauthorized access to your applications or data.

There may be [steps] where you set computers to automatically update your operating system and some of your key software applications, because hackers commonly use vulnerabilities within those systems, those applications and operating systems, counting on the fact that you haven't yet done the update or the patch that might have been released. Doing things like just turning your computer off each night and rebooting it the next day to clear out your system and circulate any updates. It might be that the update is only going to happen if you restart your computer. So, there is some basic blocking and tackling that is out there.

Yes, these are important things for an entity and accounting and finance individuals within an organization. Also, thinking about CPAs and CPA firms where I [have to consider], as I make recommendations to my clients, how does that apply to me? What should I be doing, myself, as well?

Ms. Grove Casey

Do you think supply chain disruption continues to be of concern from a risk management perspective?

Ms. Louis

Yes, I think globally there continues to be a ripple effect. Even early supply chain is still [affected by] the cost of materials and labor and other things, so it tends to have a rippling effect over a longer period of time. Logistical disruptions might cause an increase in costs, which causes me to have a higher cost of inventory, which causes me to have concern about the net realizable value of that inventory as I am still carrying inventory on my books. Some inventory is subject to rapid obsolescence but, yet, the cost of that inventory that I had (that I am carrying from previous supply chain disruptions) might still be an issue as I think about the valuation of that inventory, for example.

Ms. Grove Casey

How have labor shortages impacted matters?

Ms. Louis

Certainly, labor costs continue to be an issue. You hear that a lot in the construction industry where there [are] general contractors. It is really hard for them to get and keep talent as they have to keep paying them more and more. Certainly, that is going to affect the profitability of projects and the bidding that has to happen. It is not just limited to the construction industry; as we look forward, there are lots of [industries] where that also is a factor.

Risk Management Challenges Expected in 2023

By Jennifer F. Louis, CPA

Introduction

To thrive in an ever-changing and complex risk environment, leaders look for the most effective way to mitigate an array of potential dangers that can obstruct strategic initiatives and operations, with accounting and financial reporting risks of equal concern.

Striving to mitigate entity-wide risk and striking a balance between risk and reward is a long-term goal. Enterprise risk management (ERM) commonly is approached through both a “big-picture” and a detailed view of the organization. Every level of the organization shares responsibility in identifying risks. A holistic approach to risk management leads to increased levels of buy-in that will strengthen the overall implementation of risk management efforts which affect the short- and long-term viability of the organization.

In particular, accounting and finance professionals find themselves developing risk management strategies or preparing to handle risk exposure. Accounting/Finance and business strategy need to be linked closely together for companies to deal effectively with risk.

According to the AICPA’s 2022 *Global State of Enterprise Risk Oversight* report, leaders face an increasing amount of risks. However, the report states that only about one third of organizations have complete ERM processes in place.

ERM is not one-size-fits-all, and an organization’s risks will differ from other organizations, but certain risks stand out as challenges for most entities. This segment will discuss a few of the major risk-management challenges currently being faced.

Economic Uncertainty

The biggest and most obvious threat to companies and organizations in 2023 is the global rise of inflation and subsequent economic downturn. While profiting during a period of high inflation is not completely impossible, it is far from ideal. Also, rising or volatile interest rates will continue to burn working capital for businesses across the economy.

In addition, the risk of a recession is adding cost-cutting pressures; however, companies should avoid the temptation to make cuts indiscriminately. Incorporating and understanding the risks and impacts of cost cutting on areas such as employee workloads or customer experience is critical.

Risk and Uncertainty Disclosures

Volatility in the business and economic environment result in the need to disclose information about the risks and uncertainties confronted by reporting entities. FASB ASC 275, *Risks and Uncertainties*, requires disclosures that focus primarily on risks and uncertainties that significantly could affect the amounts reported in the financial statements in the near term or the near-term functioning of the reporting entity (defined as a period of time not to exceed one year from the date of the financial statements).

Reporting entities should make disclosures in their financial statements about the risks and uncertainties existing as of the date of those statements in the following areas:

- Nature of operations, including the activities in which the entity is currently engaged if principal operations have not commenced
- Use of estimates in the preparation of financial statements
- Certain significant estimates
- Current vulnerability due to certain concentrations

These four areas of disclosure are not mutually exclusive; the information required by some may overlap. Accordingly, the disclosures required may be combined in various ways, grouped together, placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other areas of GAAP.

The disclosure requirements of ASC 275 do not encompass risks and uncertainties that might be associated with any of the following:

- Management or key personnel
- Proposed changes in government regulations
- Proposed changes in accounting principles
- Deficiencies in the internal control structure
- The possible effects of acts of God, war, or sudden catastrophes

Related to the entity's nature of operations or activities, if an entity has commenced planned principal operations, the entity's financial statements should include a description of the major products or services the reporting entity sells or provides and its principal markets, including the locations of those markets.

If the entity operates in more than one business, the disclosure also shall indicate the relative importance of its operations in each business and the basis for this determination—for example, assets, revenues, or earnings. Not-for-profit entities' disclosures should briefly describe the principal services performed by the entity and the revenue sources for the entity's services. Disclosures about the nature of operations or activities need not be quantified; relative importance could be conveyed by use of terms such as predominately, about equally, or major and other.

In relation to certain significant estimates, ASC 275 requires discussion of estimates when, based on known information available before the financial statements are issued or are available to be issued, it is reasonably possible that the estimate will change in the near term and the effect of the change will be material. The estimate of the effect of a change in a condition, situation, or set of circumstances that existed at the date of the financial statements should be disclosed, and the evaluation shall be based on known information available before the financial statements are issued or are available to be issued.

Disclosures should indicate the nature of the uncertainty and include an indication that it is at least reasonably possible that a change in the estimate will occur in the near term. If the estimate involves a loss contingency covered by Subtopic 450-20, the disclosure also should include an estimate of the possible loss or range of loss, or state that such an estimate cannot be made. Disclosure of the factors that cause the estimate to be sensitive to change is encouraged but not required. The words "reasonably possible" need not be used in the disclosures.

Many entities use risk-reduction techniques to mitigate losses or the uncertainty that may result from future events. If the entity determines that the criteria are not met as a result of risk-reduction techniques, the required disclosures described and disclosure of the risk-reduction techniques are encouraged but not required.

Whether an estimate meets the criteria for disclosure does not depend on the amount that has been reported in the financial statements, but rather on the materiality of the effect that using a different estimate would have had on the financial statements. Simply because an estimate resulted in the recognition of a small financial statement amount, or no amount, does not mean that disclosure is not required.

The following are just a few examples of assets and liabilities and related revenues and expenses, and of disclosure of gain or loss contingencies included in financial statements that, based on facts and circumstances existing at the date of the financial statements, may be based on estimates that are particularly sensitive to change in the near term:

- Inventory subject to rapid technological obsolescence
- Long-lived assets whose value may become impaired

- Specialized equipment subject to technological obsolescence
- Valuation allowances for deferred tax assets based on future taxable income
- Capitalized computer software costs
- Valuation allowances for loans
- Environmental remediation-related obligations
- Litigation-related obligations
- Contingent liabilities for obligations of other entities
- Amounts reported for long-term obligations, such as amounts reported for pensions and postemployment benefits
- Estimated net proceeds recoverable, the provisions for expected loss to be incurred, or both, on disposition of a business or assets
- Amounts reported for long-term contracts

Related to current vulnerabilities due to certain concentrations, vulnerability from concentrations arises because an entity is exposed to risk of loss greater than it would have, had it mitigated its risk through diversification. Such risks of loss manifest themselves differently, depending on the nature of the concentration, and vary in significance.

Financial statements should disclose certain concentrations if, based on information known to management before the financial statements are issued or are available to be issued, *all* the following criteria are met:

- The concentration exists at the date of the financial statements.
- The concentration makes the entity vulnerable to the risk of a near-term severe impact.
- It is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

“Severe impact” is defined as a significant financially disruptive effect on the normal functioning of an entity. Severe impact is a higher threshold than material. The concept of severe impact, however, includes matters that are less than catastrophic.

Matters that are important enough to influence a user’s decisions are deemed to be material, yet they may not be so significant as to disrupt the normal functioning of the entity. For example, some events are material to an investor because they might affect the price of an entity’s capital stock or its debt securities, but they would not necessarily have a severe impact on (disrupt) the entity itself. Matters that are catastrophic include, for example, those that would result in bankruptcy.

ASC 275 requires disclosure of certain defined concentrations known to management, rather than a wider range of concentrations, based on information of which management is reasonably expected to have knowledge.

Concentrations, including known group concentrations, require disclosure if they meet the criteria. Group concentrations exist if a number of counterparties or items that have similar economic characteristics collectively expose the reporting entity to a particular kind of risk.

Some concentrations may fall into more than one of the following categories:

- Concentrations in the volume of business transacted with a particular customer, supplier, lender, grantor, or contributor. The potential for the severe impact can result, for example, from total or partial loss of the business relationship. It is always considered at least reasonably possible that any customer, grantor, or contributor will be lost in the near term.

- Concentrations in revenue from particular products, services, or fund-raising events. The potential for the severe impact can result, for example, from volume or price changes or the loss of patent protection for the particular source of revenue.
- Concentrations in the available sources of supply of materials, labor, or services, or of licenses or other rights used in the entity's operations. The potential for the severe impact can result, for example, from changes in the availability to the entity of a resource or a right.
- Concentrations in the market or geographic area in which an entity conducts its operations. The potential for the severe impact can result, for example, from negative effects of the economic and political forces within the market or geographic area. It is always considered at least reasonably possible that operations located outside an entity's home country will be disrupted in the near term.

An assessment of whether a disclosure is required should not be found to be in error simply as a result of future events. For example, reporting a concentration not followed by a severe impact does not imply that the disclosure should not have been made, because something that has only a reasonably possible chance of occurring obviously might not occur. Similarly, the occurrence of a severe impact related to a concentration not disclosed in the prior-year financial statements would not suggest noncompliance with the requirements if an appropriate judgment had been made that a near-term severe impact was not at least reasonably possible at the prior reporting date. In addition, a severe impact may arise from a concentration of which management did not have knowledge at the time the financial statements were issued.

When financial statements are prepared using a special-purpose framework, such as the income tax basis or the Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs), and when the financial statements contain items that are the same as, or similar to, those contained in statements prepared using U.S. GAAP, similar informative disclosures need to be made in the financial statements. With that said, disclosures need not include information that is not relevant to the basis of accounting.

Concentrations of Risk in Bank Deposits

Disclosure of concentrations meeting the criteria should include information that is adequate to inform users of the general nature of the risk associated with the concentration. For example, if an entity holds deposits in excess of Federal Deposit Insurance Corporation (FDIC) insurance limits.

On Friday, March 10, 2023, Silicon Valley Bank (SVB) was closed by the California Department of Financial Protection and Innovation. The FDIC was named receiver and immediately created the Deposit Insurance National Bank of Santa Clara to facilitate the resolution of SVB. The bank's sudden failure meant there were many questions about the ability to access accounts and funds held at the bank at the time it closed.

The FDIC is an independent agency of the United States government. The FDIC protects depositors of insured banks located in the United States against the loss of their deposits if an insured bank fails. FDIC insurance covers depositors' accounts at each insured bank, dollar-for-dollar, including principal and any accrued interest through the date of the insured bank's closing, up to the insurance limit (currently at \$250,000 per depositor within each insured bank). The FDIC adds together all single accounts owned by the same person at the same bank and insures the total up to \$250,000. FDIC insurance covers all types of deposits received at an insured bank but does not cover investments, even if they were purchased at an insured bank.

The FDIC insures deposits that a person holds in one insured bank separately from any deposits that the person owns in another separately chartered insured bank. For example, if a person has a certificate of deposit at Bank A and has a certificate of deposit at Bank B, the amounts would each be insured separately up to \$250,000. Funds deposited in separate branches of the same insured bank are not separately insured.

What the FDIC covers:

- Checking accounts
- Negotiable order of withdrawal (NOW) accounts
- Savings accounts
- Money market deposit accounts (MMDA)
- Time deposits, such as certificates of deposit (CDs)
- Cashier's checks, money orders, and other official items issued by a bank

What the FDIC does not cover:

- Stock investments
- Bond investments
- Mutual funds
- Life insurance policies
- Annuities
- Municipal securities
- Safe deposit boxes or their contents
- U.S. Treasury bills, bonds or notes (which are already backed by the full faith and credit of the U.S. government)

Focus on Sweep Programs

Many commercial banking customers participate in sweep programs that enable the customer to have excess cash in their main deposit accounts (e.g., checking accounts) “swept” to other accounts and used to purchase shares in money market mutual funds (MMMFs) and other similar investment securities.

The nature of sweep programs vary. For example:

- Programs that establish a target balance amount for the customer's applicable deposit account and sweep cash in and out of the deposit account to maintain that target balance
- Programs that establish, in addition to the target balance amount, a target investment return amount
- Programs that sweep customer deposits held in deposit accounts with the bank for overnight purchases of securities and then sell the securities in the morning, returning the funds to the customer's deposit accounts

Regardless of the specifics of the sweep program, swept funds can generally be divided into two buckets.

1. Some swept funds are used by the bank to purchase, *on behalf* of the customer, external assets, such as shares in an MMMF. Holdings of assets, such as MMMFs purchased through external investment fund management, should *not* constitute deposits and are not expected to be subject to the resolution of funds on deposit by FDIC insurance. Pursuant to 12 CFR §360.8(e), for funds that are *not deposits*, the bank must disclose to the customer, in the applicable program agreement, the status such assets would have if the institution failed. In general, such assets should belong to the bank's customer, even if the bank made the share purchases as agent of the customer and held such shares in the bank's name and on behalf of its customers.

2. Some swept funds are held by the bank in accounts (such as omnibus accounts) that may earn interest or other returns paid by the bank. These funds generally are *not* holdings of shares in an external asset, such as an MMMF, that belong to the customer. This “cash” remains in a deposit account and will likely constitute a deposit.

ESG Reporting

Consumers, investors, employees, and communities want to know:

- How is the organization protecting the environment?
- Is the entity operated ethically?
- Are employees treated well?

The focus on environmental, social, and governance (ESG) initiatives is rapidly growing, and its importance has made great strides over the last decade. Climate change, human rights, diversity, equity and inclusion, and data security are just a few factors that ESG encompasses.

Accounting and finance professionals serve a critical role in ESG reporting. In addition, changing regulatory requirements and new reporting standards are pushing companies to see the need for ESG advisory and assurance services.

In March 2022, the SEC recommended new rules calling for an increase in climate change disclosures. The European Union, as part of the Corporate Sustainability Reporting Directive, and the International Sustainability Standards Board also released proposals for new disclosure requirements. It is a crucial time for accounting and finance professionals to hone their understanding of ESG issues.

The following are some key ESG-related points of interest:

- CPAs are well positioned to meet marketplace demands with the innate skills, experience, and systems to assure the performance of quality services and core values of independence, integrity, and competency. Already, firms are building on services to help clients with their ESG strategy, reporting, and assurance needs.
- Corporate finance leaders are beginning to lead internal efforts to gather and report on ESG efforts to improve decision making and demonstrate value creation. Accounting and finance professionals will need to expand their knowledge of the category to better advise clients and organizations on ESG best practices.
- Today’s consumers and employees want to buy from and work for organizations whose values align with their own. Firms and organizations that adopt ESG practices will be well positioned to secure top talent and build strong client and customer relationships.
- Investors, particularly the younger generation, want to work with companies that invest responsibly and balance purpose with profit. ESG reporting will become a cornerstone of financial reporting.

Cybersecurity Risk Management

Cybersecurity plays a crucial role in an organization’s risk management strategy and should not rest purely on the shoulders of IT professionals. With a significant increase in ransomware and phishing attempts, cybersecurity programs are vital for entities of any size to handle attacks when they occur. Cyberattacks can cause significant harm to an entity and can damage its brand and reputation, which is why minimizing risk is essential.

The following are a few quick tips to review with internal or external IT personnel to set priorities and determine what steps to prioritize to increase an organization’s resilience to attacks:

1. Require automatic screen locking on all workstations to minimize the opportunity for unauthorized access to data and applications.

2. Set computers to automatically update the operating system and key applications, as hackers commonly use known vulnerabilities to search for systems and applications that have yet to be updated.
3. Require employees to turn off computers at night and reboot daily to clear systems and circulate updates.
4. Use enhanced password controls, such as requiring at least 14 characters, changing passwords at least four times per year, and other best practices.
5. Consider the use of password managers that create an encrypted storage space for user names, passwords, and other vital information.
6. Implement multi-factor authentications to verify sign-in attempts, such as biometric scans, sending a code to a different email/text, or a physical security fob.
7. Develop a policy to greet office visitors to better secure on-premises data.
8. Secure onsite file servers in unmarked, locked rooms to deter physical theft.
9. Run computers on encrypted storage disks, secured servers, or in a cloud-based environment.
10. Document all equipment, databases, and other resources to ensure that only trusted, validated users and equipment can connect to IT resources.
11. Ensure all IT resources, including mobile devices, have antivirus/security software installed.
12. Test back-up policies and procedures to ensure they are operating as intended.
13. Use encrypted means to transmit data.
14. Train employees about phishing schemes and other vulnerabilities, and how to respond if they should fall victim to a breach.
15. Review IT and insurance policies annually to ensure that all emerging risks and trends are appropriately covered.

Accounting and finance departments in particular must adapt to new cyber threats. It is essential to implement risk strategies, build cyber resilience, and develop the capacity to respond quickly and effectively to cyberattacks.

Supply Chain Disruption

The ongoing disruptions to the global supply chain also have had a tremendous ripple effect across many lines of business. This environment requires a deeper recognition of the external and system risks that threaten financial and operational resiliency.

Companies need to understand where the potential risks lie. High materials costs, labor shortages, natural disasters, and logistics disruption are all factors that influence supply chains. Building resilience and mitigating risks in the supply chain are crucial.

For example, logistics disruptions can result in increased costs being capitalized into inventory. Supply chain disruptions can result in higher costs for freight, warehouse capacity, labor, and other items. These costs may be capitalized into inventory, resulting in a higher inventory cost on the balance sheet. The higher cost of inventory may require writing inventory down to net realizable value (NRV) or market.

Entities may not be able to offset the higher costs with higher selling prices. Inventories should be valued at either the lower of cost and NRV or the lower of cost or market, depending on the cost method, in accordance with FASB ASC 330, *Inventory*. When evidence exists that the NRV of inventory or market is lower than its cost, the difference should be recognized as a loss in earnings in the period in which it occurs. A loss may be required due to changes in

price levels, among other causes. A previously recorded inventory write-down should not be reversed when the circumstances that gave rise to the write-down no longer exist.

FASB ASC 330 does not provide specific guidance on applying the lower of cost and NRV/lower of cost or market model to raw materials and work in process (WIP). Different approaches to determining NRV for raw materials and WIP are possible, and professional judgment will need to be exercised to determine what approach is most appropriate in the circumstances.

Logistics disruptions and labor shortages may result in reduced production at manufacturing facilities which raises the risk of overcapitalization of inventory overhead. Supply chain disruptions have led to abnormal declines in production levels at some entities. FASB ASC 330 requires fixed production overheads to be allocated to the costs of inventory conversion based on the normal capacity of the production facilities. The amount of fixed overhead allocated to each unit of production should not be increased as a consequence of abnormally low production or an idle plant. Therefore, entities that encountered abnormally low production levels may be required to expense fixed production overheads related to unused capacity, rather than allocate those overhead amounts to inventory.

Logistics problems may introduce added risk that inventory is overstated or understated because purchases or shipments are not recorded in the proper period, and inventory held on consignment for or by third parties is improperly accounted for when recorded. Shipping bottlenecks caused by supply chain disruptions may result in unusual delays in receipts of purchased inventory, and delays in shipments of sold inventory. The normal flow of inventory purchases and sales at an entity may be disrupted and additional analysis of purchases cutoff, sales cutoff, in-transit inventory, and consignment may be warranted.

In addition, supply chain disruptions more likely may impact transfer of control considerations for performance obligations satisfied at a point in time, rather than those satisfied over time. Unusual shipping jams can affect when control of a good is transferred to a customer, raising the risk that revenue is overstated or understated.

Talent Retention and Increasing Labor Costs

Today's labor shortage and skills gap challenges will continue into 2023 as entities bolster their recruitment and retention efforts to reach and retain talent across all levels of the organization. Entities need to explore more diverse avenues, job boards, and organizations to find the shared skills needed to support the business, dipping into all major and secondary markets.

Lack of succession planning is also a concern. "Boomers" are a massive American population cohort. As boomers exit the workforce, there is not enough workforce replacement. Successfully transitioning business ownership to either next-generation family members or external new owners will require more time and dedication to training the future leaders of tomorrow.

GROUP STUDY MATERIALS

A. Discussion Problems

1. List the areas in which reporting entities should make disclosures about risks and uncertainties, and how and where the disclosures should be reported in the financial statements.
2. Discuss what types of deposits are covered by FDIC insurance.
3. Discuss some of the steps that an organization can implement to increase its effectiveness in handling cyberattacks.

B. Suggested Answers to Discussion Problems

1. Reporting entities should make disclosures in their financial statements about the risks and uncertainties existing as of the date of those statements in the following areas:
 - a. Nature of operations, including the activities in which the entity is currently engaged if principal operations have not commenced
 - b. Use of estimates in the preparation of financial statements
 - c. Certain significant estimates
 - d. Current vulnerability due to certain concentrations

These four areas of disclosure are not mutually exclusive; the information required by some may overlap. Accordingly, the disclosures required may be combined in various ways, grouped together, placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other areas of GAAP.

2. The FDIC insures deposits that a person holds in one insured bank separately from any deposits that the person owns in another separately chartered insured bank. For example, if a person has a certificate of deposit at Bank A and has a certificate of deposit at Bank B, the amounts would each be insured separately up to \$250,000. Funds deposited in separate branches of the same insured bank are not separately insured.

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- Municipal securities

- Safe deposit boxes or their contents
- U.S. Treasury bills, bonds or notes (which are already backed by the full faith and credit of the U.S. government)

FDIC insurance covers all types of deposits received at an insured bank but does not cover investments, even if they were purchased at an insured bank.

3. To increase an organization's resilience to cyberattacks, the following are a few areas to review with IT personnel:
 - a. Requiring automatic screen locking on all workstations
 - b. Setting computers to automatically update the operating system and key applications
 - c. Requiring employees to turn off computers at night and reboot daily
 - d. Using enhanced password controls

Additional areas include considering the use of password managers, implementing multi-factor authentications, developing policies for greeting office visitors, securing file servers, encrypting storage disks, documenting all equipment and databases, installing antivirus/security software, testing back-up policies and procedures, using encrypted means to transmit data, training employees about phishing schemes and proper response, and reviewing IT and insurance policies annually.

GLOSSARY OF KEY TERMS

Attest Engagements—include engagements where a CPA issues an examination or audit, review, compilation, or agreed-upon procedures report on subject matter, or an assertion about subject matter, that is the responsibility of another party.

Comfort Letters—a letter that guarantees nothing, but attests to specific facts

Direct Examination—practitioner measures or evaluates the underlying subject matter against the criteria and performs other procedures to obtain sufficient appropriate evidence to express an opinion. The responsible party does not provide an assertion.

EBITDA—Earnings before interest, taxes, depreciation and amortization

ESG—Environmental, Social, Governance

ERM—Enterprise Risk Management

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

IAASB—International Audit and Assurance Standards Board

Personal Financial Statements—statement of financial condition and a Statement of changes in net worth

PCAOB—Public Company Accounting Oversight Board

SSAEs—Statements on Standards for Attestation Engagements

SSARS—Statements on Standards for Accounting and Review Services

Statement of Financial Condition—Lists assets and liabilities in order of liquidity for an individual or family unit

Statement of Changes in Net Worth—this personal financial statement has sections including realized increases in net worth, realized decreases in net worth, unrealized increases in net worth, and unrealized decreases in net worth

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| Kurt Oestrieher | Feb-Jun |

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| | |
|-------------------|---------|
| Russ Madray | Jan-May |
|-------------------|---------|

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

1. According to Kurt Oestrieher, most personal financial statements are issued using which of the following?
 - A. United States generally accepted accounting principles (GAAP).
 - B. The income tax basis of accounting.
 - C. The cash basis of accounting.
 - D. There are no official rules for personal financial statements, so the way they are issued is wildly varied.

2. According to Kurt Oestrieher, who is the reporting entity for a set of personal financial statements?
 - A. One individual must serve as the reporting entity for one set of personal financial statements.
 - B. If an individual is married, both spouses are always considered the reporting entity.
 - C. The reporting entity varies and can be an individual, a married couple, or even an entire family unit.
 - D. Not only can reporting entities include family units, but they can also include groups of friends.

3. According to Kurt Oestrieher, what is the main (and sometimes only) statement in a set of personal financial statements?
 - A. The statement of cash flows.
 - B. The statement of equity.
 - C. The statement of assets and liabilities.
 - D. The statement of financial condition.

4. According to Kurt Oestrieher, assets and liabilities are valued at what amount in a set of personal financial statements?
 - A. Fair market value.
 - B. Estimated current values.
 - C. Appraised value.
 - D. Most recent purchase price.

5. According to Kurt Oestrieher, what is a benefit of compiling personal financial statements?
 - A. All disclosures are omitted in compiled financial statements.
 - B. Representation letters are not necessary for compilation engagements.
 - C. The compilation report is helpful because the financial statements are squirrely.
 - D. A report will not be needed if the statements are part of a prescribed form.

Continued on next page

6. According to Jennifer Louis, attest services always do which of the following?
 - A. Cover financial information, not nonfinancial information.
 - B. Provide assurance on the covered information.
 - C. Compare covered information to specific criteria.
 - D. Fall under the Statements on Standards for Attestation Engagements.
7. According to Jennifer Louis, what do CPAs provide clients in a comfort letter?
 - A. Assurance about whether the subject matter is fairly presented.
 - B. An opinion about the subject matter based on certain criteria.
 - C. A report that describes the conclusion drawn based on the subject matter.
 - D. Information about the subject matter allowing the client to form their own conclusion.
8. According to Jennifer Louis, what other type of attestation engagement is most like an audit?
 - A. An examination.
 - B. A compilation.
 - C. An agreed-upon procedures engagement.
 - D. A preparation engagement.
9. According to Jennifer Louis, what is different about a direct examination under SSAE No. 21?
 - A. The responsible party provides an assertion to the CPA.
 - B. The CPA may evaluate the subject matter without an assertion.
 - C. It covers prospective or pro forma financial information, but not historical.
 - D. The CPA only performs the procedures provided by the engaging party.
10. According to Jennifer Louis, does the code of professional conduct apply to attestation engagements?
 - A. Yes, the code of professional conduct applies to all services a CPA provides, including attestation engagements.
 - B. Yes, the code of professional conduct applies, but the independence rules never apply when CPAs provide assurance.
 - C. No, the code of professional conduct does not apply to attestation engagement unless the engaging party is in a specific industry.
 - D. No, the code of professional conduct does not specifically apply to attestation engagements.

Continued on next page

11. According to Jennifer Louis, based on the report issued by the AICPA (The Global State of Enterprise Risk Oversight), approximately how many organizations have a complete enterprise risk management (ERM) process in place?
 - A. One third.
 - B. Half.
 - C. Two thirds.
 - D. Three fourths.
12. According to Jennifer Louis, only near-term risks affect an entity's financial position or financial statement disclosures, and near-term does not exceed how long after the balance sheet date?
 - A. One month.
 - B. Six months.
 - C. One year.
 - D. Two years.
13. According to Jennifer Louis, what does it mean if a risk could have a *severe effect* on a business entity?
 - A. The effect would be disruptive, but not necessarily material to the financial statements.
 - B. The effect would be catastrophic, causing the business to shut its doors.
 - C. The effect would be both material to the financial statements and disrupt normal operations.
 - D. The effect would be material to the financial statements but not necessarily disrupt operations.
14. According to Jennifer Louis, what is the current cap on FDIC insurance for one depositor at one insured bank?
 - A. \$100,000.
 - B. \$250,000.
 - C. \$500,000.
 - D. \$1 million.
15. According to Jennifer Louis, turning off your computer each night and rebooting it the next day is a simple action that can help manage what type of risk?
 - A. Supply chain disruption.
 - B. Environmental, social, and governance (ESG).
 - C. Concentrations.
 - D. Cybersecurity.

Subscriber Survey Evaluation Form

Please take a few minutes to complete this survey related to **CPE Network® A&A Report** and return with your quizzer or group attendance sheet to 2395 Midway Road, Carrollton, Texas 75006. All responses will be kept confidential. Comments in addition to the answers to these questions are also welcome. Please send comments to CPLgrading@thomsonreuters.com.

How would you rate the topics covered in the June 2023 **CPE Network® A&A Report**? Rate each topic on a scale of 1–5 (5=highest):

| | Topic Relevance | Topic Content/ Coverage | Topic Timeliness | Video Quality | Audio Quality | Written Material |
|-------------------------------|----------------------|-------------------------------|----------------------|----------------------|----------------------|----------------------|
| Personal Financial Statements | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |
| Nonaudit Attestation Options | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |
| Risk Management | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> | <input type="text"/> |

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

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

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

How would you rate the effectiveness of the speakers in the June 2023 **CPE Network® A&A Report**? Rate each speaker on a scale of 1–5 (5 highest):

| | Overall | Knowledge of Topic | Presentation Skills |
|-----------------|---------|-----------------------|------------------------|
| Jennifer Louis | _____ | _____ | _____ |
| Kurt Oestrieher | _____ | _____ | _____ |

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

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

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

Were program materials accurate? Yes ☐ No ☐ _____

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

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

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

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

Specific Comments: _____

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Once Again, Thank You...

Your Input Can Have a Direct Influence on Future Issues!

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

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Date: _____

E-mail address:

License State and Number:

CPE Network/Webinar Delivery Tracking Report

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

[illegible]

CHECKPOINT LEARNING NETWORK

CPE NETWORK®

USER GUIDE

REVISED May 1, 2023

Welcome to CPE Network!

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

This User Guide has the following sections:

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

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

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

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

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

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

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

Requesting Participant CPE Certificates

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

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

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

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

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

Requesting Participant CPE Certificates

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

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

Email: CPLgrading@tr.com

Fax: 888.286.9070

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

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

Incomplete submissions will be returned to you.

“Self-Study” Format

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

Self-Study—Print

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

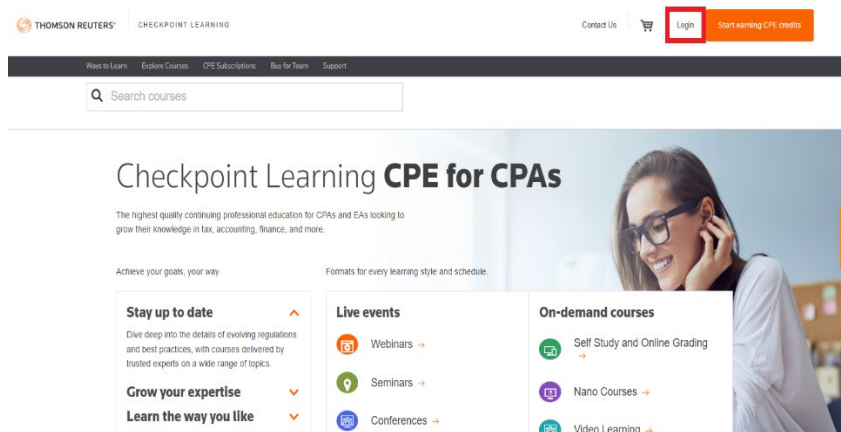
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

Thomson Reuters
PO Box 115008
Carrollton, TX 75011-5008

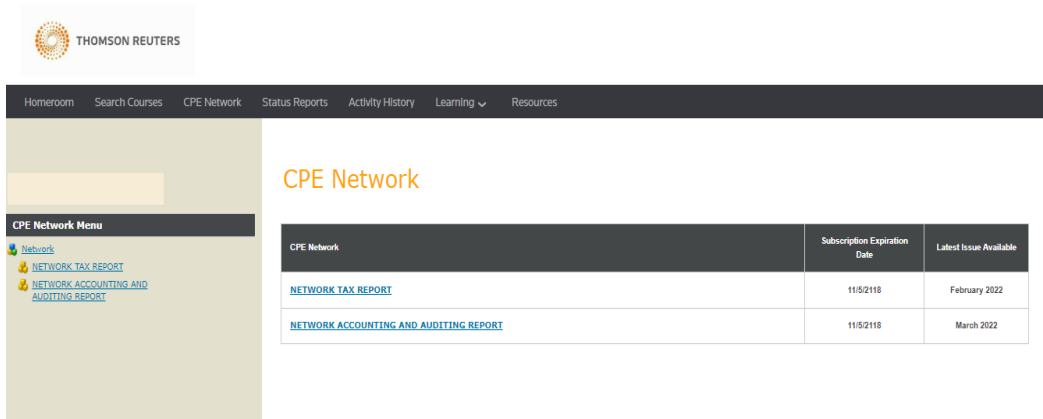
Self-Study—Online

Follow these simple steps to use the online program:

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

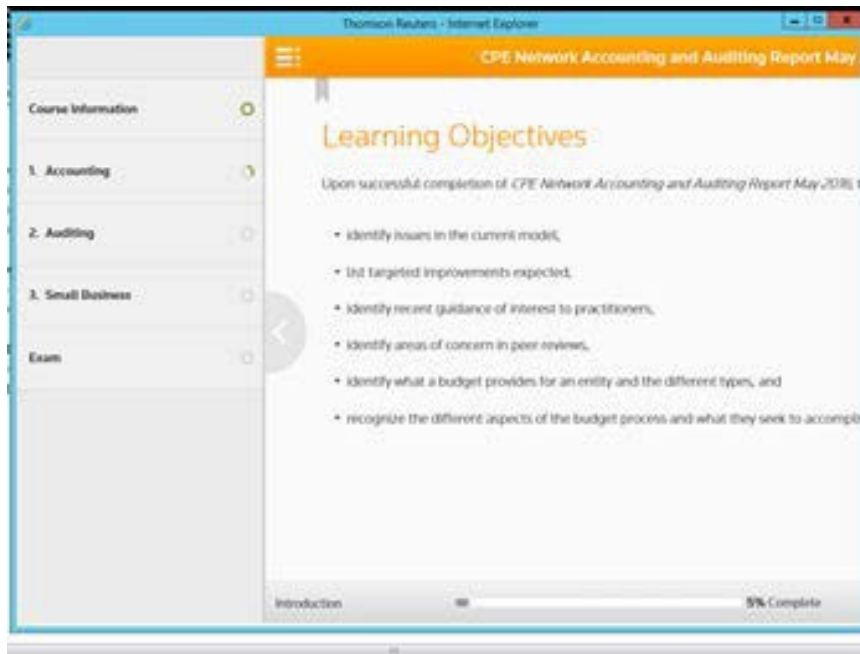


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



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

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



Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2018

Learning Objectives

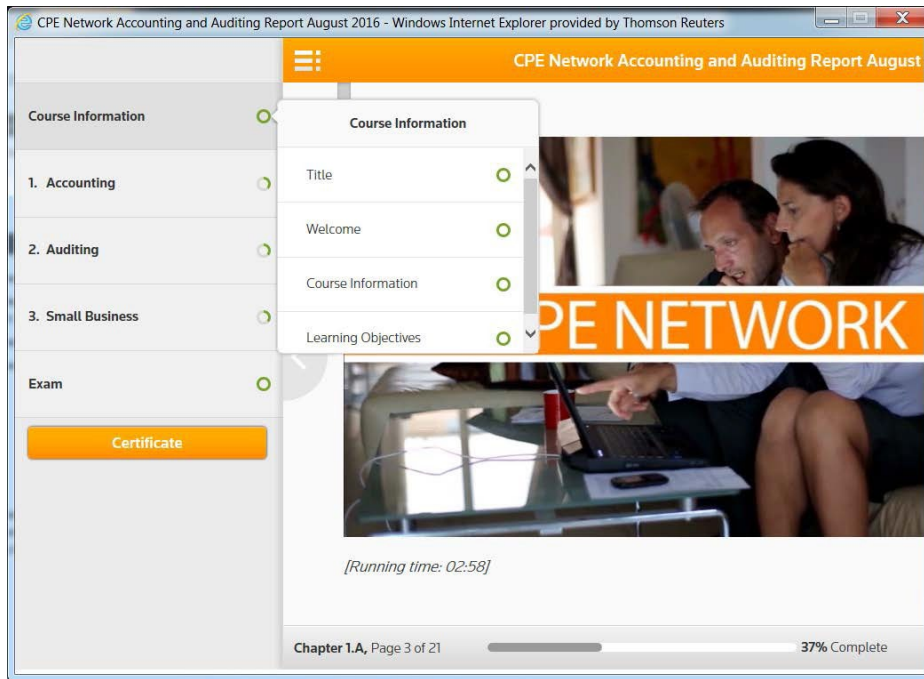
Upon successful completion of *CPE Network Accounting and Auditing Report May 2018*, the participant will be able to:

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

Introduction 5% Complete

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

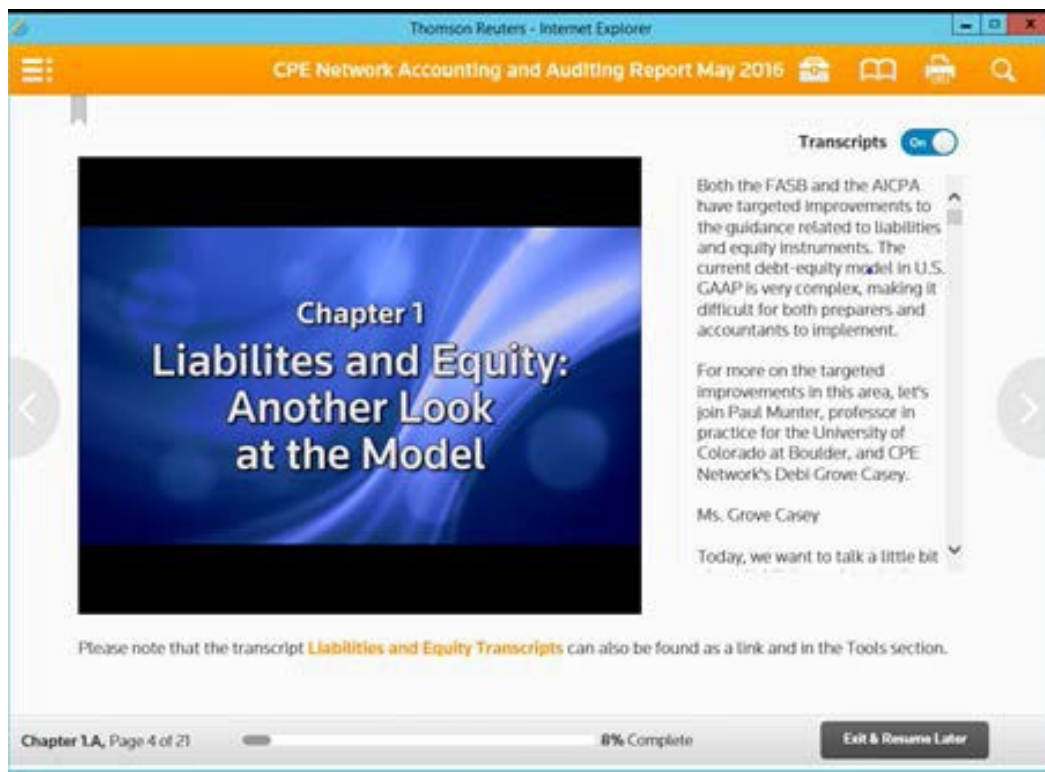
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



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



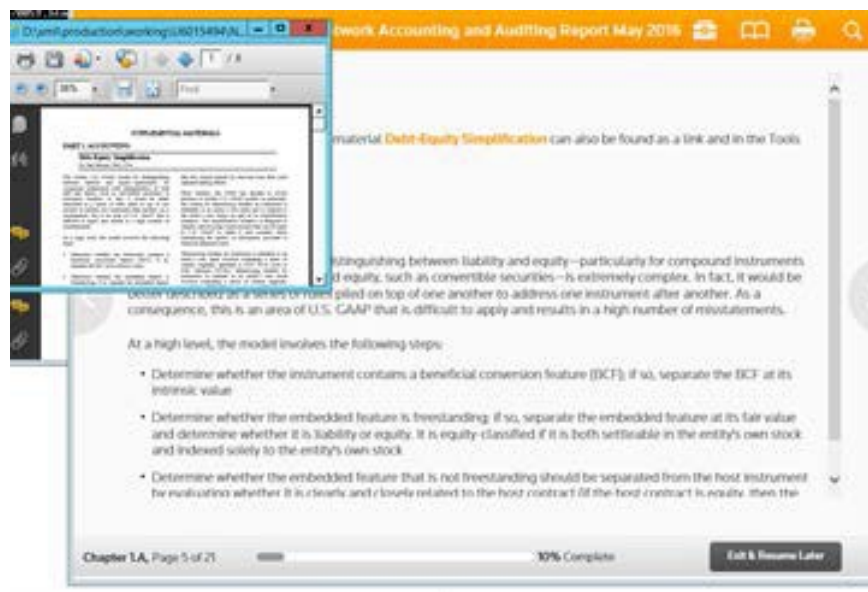
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.



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



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



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

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

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

Suggested Answers to Discussion Problems

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

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

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

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

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

The screenshot shows a web interface for the CPE Network Accounting and Auditing Report June 2016. The header is orange with a menu icon, title, and icons for a calculator, book, printer, and search. The main content area is titled "Course Exams Completed" and contains text about completing the exam and two orange buttons: "Review My Answers" and "Grade My Answers". The footer shows "Course, Completed", a progress bar at 100% Complete, and an "Exit & Resume Later" button.

Course Exams Completed

You have completed the exam for this course.

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

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

Review My Answers

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

Grade My Answers

Course, Completed 100% Complete Exit & Resume Later

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

Additional Features Search

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

Search Results are displayed with the number of hits.

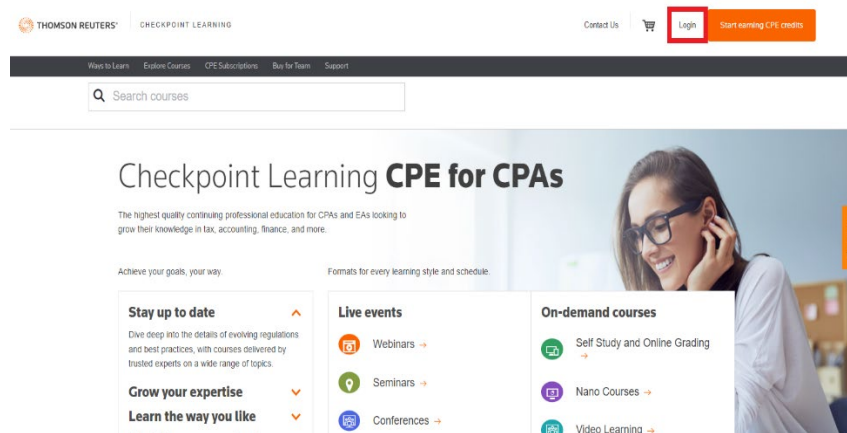
Print

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

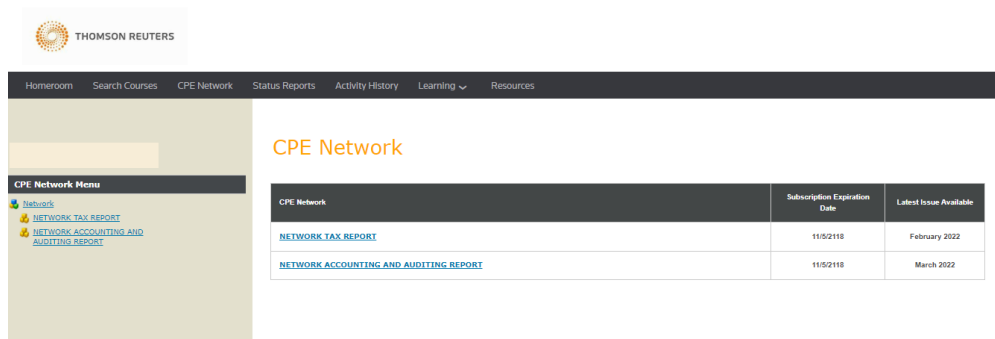
Transitioning From DVDs

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

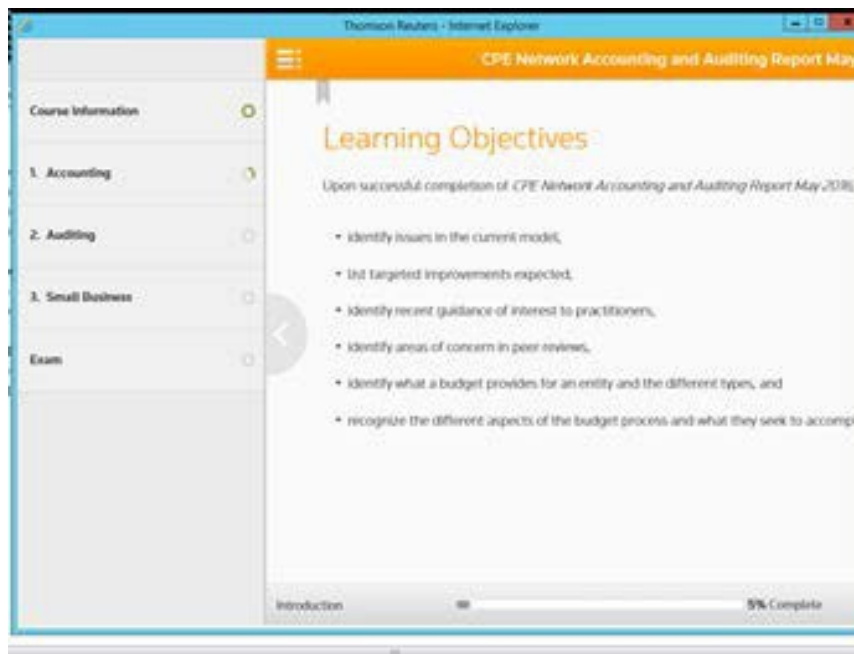
- Go to www.checkpointlearning.thomsonreuters.com .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



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

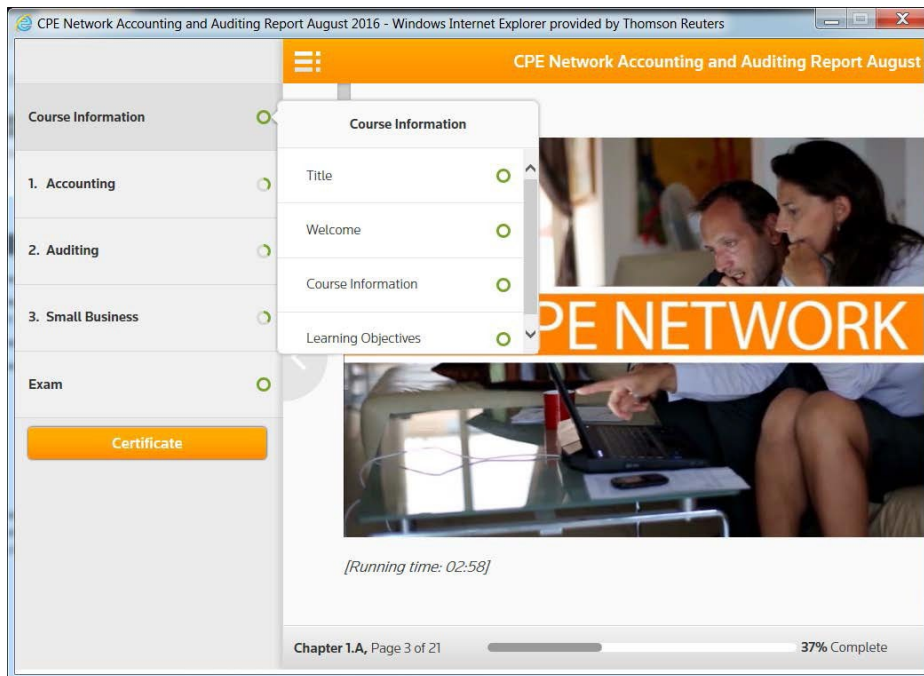


The Chapter Menu is in the gray bar at the left of your screen:

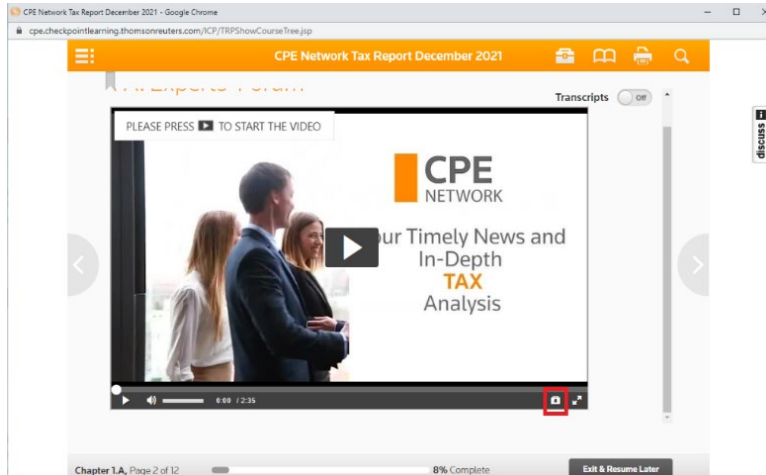


Click down to access the dropdown menu and move between the program Chapters.

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



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



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

PDFs may be downloaded from either the course toolbox in the upper right corner of the Checkpoint Learning screen or from the email sent by CPENetworkgroupstudy.

What Does It Mean to Be a CPE Sponsor?

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

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

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

CPE Sponsor Requirements

Determining CPE Credit Increments

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

Program Presentation

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

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

Disclose Significant Features of Program in Advance

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

Monitor Attendance

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

Real Time Instructor During Program Presentation

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

Elements of Engagement

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

Awarding CPE Certificates

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

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

Seminar Quality Evaluations for Firm Sponsor

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

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

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

Retention of Records

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

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

Appendix: Forms

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

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

Getting Help

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

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