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**CPE NETWORK**

## ACCOUNTING & AUDITING REPORT

**JULY 2023**

**VOLUME 36, ISSUE 6**

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Topics for future editions may include:

- Accounting for Corporate Reorganizations
- Fraud trends in SPACs
- Assessing Materiality

## EXECUTIVE SUMMARY

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### PART 1. ACCOUNTING

#### FASB Update ..... 3

Russ Madray, CPA reviews recent FASB guidance issued in the last 12 months. The topics range from supplier finance programs to common control arrangements with leasehold improvements. *[Running time: 34:39]*

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

- Determine characteristics and benefits of structured payable arrangements
- Identify the purpose of certain recent ASUs
- Identify which entities may apply the practical expedient provided in ASU 2023-01
- Identify which accounting guidance provides entities to use the proportional amortization method for certain qualifying tax equity investments

### PART 2. AUDITING

#### Transition Issues with SAS 145 ..... 17

Jennifer Louis, CPA considers changes and challenges firms may face in implementing the guidance in SAS 145 for their audits with year ends of December 31, 2023. *[Running time: 28:46]*

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

- Identify the effective date of SAS 145
- Determine the impact of SAS 145 on the basic audit model and the concept of inherent risk
- Identify the impact of SAS 145 on the auditor's assessment of risk

### PART 3. SMALL BUSINESS

#### Comfort Letters ..... 34

Kurt Oestrieher, CPA, discusses engagements CPAs are frequently asked to perform for third parties related to verification of information. *[Running time: 25:51]*

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

- Determine what guidance applies for the types of engagements clients are requesting
- Identify what engagements CPAs may not perform
- Identify the types of engagements related to differing levels of assurance
- Identify the most appropriate engagement for assurance on forecasted or projected financial information

## ABOUT THE SPEAKERS

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

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

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

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Recommended field of study(ies) (Refer to executive summary)	
Program Level	Update
Prerequisites (Circle One)	<ul style="list-style-type: none"> <li>• Basic Accounting and Auditing professional experience</li> <li>• Basic Tax professional experience</li> <li>• Basic Governmental professional experience</li> </ul>
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### PART 1. ACCOUNTING

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#### FASB Update

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While the FASB's large projects on revenue, leases, and financial instruments have been concluded for some time, the clean up work associated with implementation and clarification has been ongoing. In this segment, we'll address guidance issued by the FASB in the past year addressing off balance sheet financing, insurance contracts, reference rate reform, common control arrangements in leases, and certain equity method and joint venture investments.

For more on the FASB's current activities, let's join Russ Madray, a CPA in Greenville, South Carolina, and CPE Network's Debi Grove Casey.

#### Ms. Grove Casey

So today we want to do a little bit of a FASB update. Now there hasn't been a lot of major new guidance coming from the FASB in recent months, but there are a few new ASUs that we need to cover. So to begin with, let's talk about ASU 2022-04, and that relates to disclosures of supplier finance program obligations.

#### Mr. Madray

Sure, that's a good place to start. That was issued in September of 2022. The purpose of this ASU is to try to bring more transparency to these supplier finance programs. Under this particular ASU, the buyer in a supplier finance program will be required to disclose some information about the key terms of the program, outstanding confirmed amounts as of the end of a period. There's a roll forward requirement in terms of the activity during the annual period, and then, also some description of where in the financial statements these outstanding amounts would be presented.

By way of a little bit of background, when an entity purchases goods or services on credit from a supplier, obviously a trade payable would arise for the invoice amount that's owed to that supplier. Sometimes the buyer will then enter into an agreement with a bank or some other intermediary where the intermediary will offer to purchase the receivables that are held by the supplier. These arrangements go by different terms and we have some listed on the slide as you see here: structured payable arrangements, vendor payable programs, open account structured vendor payable programs, sometimes called reverse factoring, supplier finance or supplier chain finance. There are different terms that are used for these types of arrangements.

Typically, the arrangements give suppliers the option to settle these trade receivables by obtaining a payment from the intermediary either before the invoice due date at some discounted amount or perhaps on the invoice date for the full amount. There are a number of benefits for the various parties in these arrangements, some examples we have listed on this next slide, it gives suppliers the ability to monetize their trade receivables and reduce their credit exposure. By selling their trade receivables to an intermediary, suppliers can receive their payment, obviously before the invoice due date, and eliminate or reduce some of that credit exposure. It also gives buyers the ability to obtain extended payment terms. Suppliers, in some cases, may be more willing to offer these extended payment terms to buyers if they can obtain early payment from an intermediary. And, sometimes intermediaries themselves might offer buyers extended payment terms. It gives intermediaries the ability to benefit from early payment discounts, rebates, transaction fees, charges, things like that. In these arrangements, intermediaries earn a spread on the basis of the relationship between their funding costs and the amount of the early payment discounts, rebates, and so on, other types of fees and charges received from the suppliers.

These arrangements can create operational benefits. Because of an intermediary's involvement, the arrangement can enhance the processing administration, control of the payments for buyers and suppliers. In some cases, it can offer an extended early payment discount period, for example, if an intermediary pays a supplier within the period where the supplier offers an early payment discount, so for example, a 2/10 net 30 type of arrangement. The intermediary might then offer the buyer a discount on the amount due for an extended period. So the intermediary might offer in this situation, a 1/10 net 60; they still earn a spread on the difference there between those discounts. Also, the

arrangements can offer a reduction of the amount due or some other type of rebate, so for example, the intermediary might offer the buyer a reduction of the amount due or reimbursement of some part of the amount paid on the basis of the net amounts paid to the suppliers. The supplier may agree to pay the intermediary fee or reduce the amount due because of the benefits it's receiving from the arrangement, again, primarily that lowered credit risk exposure or earlier payment of that amount. All in all, that's what these programs are about. As I said, this ASU is designed to enhance the transparency by requiring some additional disclosures related to these types of arrangements.

**Ms. Grove Casey**

Let's talk about the types of disclosures that are required because it reminds me a lot of the off-balance sheet financing arrangements that were previously addressed related to disclosures.

**Mr. Madray**

That's true. What this ASU does, basically, is it requires the buyer in a supplier finance program to disclose both some qualitative and some quantitative information about the program itself. These disclosures would apply to programs that have all three of the characteristics that you see on this next slide. First, an entity enters into an arrangement with a finance provider or intermediary. Secondly, the entity confirms supplier invoices as valid to the finance provider or intermediary under the agreement that I mentioned in the first bullet point. And then, finally, the entity supplier has the option to request early payment from a party other than the entity for invoices that the entity has confirmed as valid.

So an arrangement that meets all three of those characteristics would need to disclose at a minimum the information that we have here on the next slide. These are annual disclosures. First, the key terms of the program, which would include the payment terms, the assets pledged, the security, and other forms of guarantees. We would also disclose the amount of the obligations outstanding at the end of the reporting period that the buyer has confirmed as valid, a description of where those obligations are presented in the balance sheet, and if they're in more than one line item, the amount of each line item has to be disclosed. Then a roll forward of the information for the annual period showing the amount at the beginning of the period, the amount added during the period, the amount settled during the period, and the amount outstanding at the end of the period. So those are all annual disclosures.

In addition, in each interim period, the buyer will need to disclose the outstanding confirmed amount as of the end of that interim period. On the next slide, we have an example that's taken directly from this ASU of this roll forward information, and how that might look. You see here the roll forwards of Entity A's outstanding obligations confirmed as valid under its supplier finance program for the years ended here. We have the confirmed obligations outstanding at the beginning of the year. We have the invoices confirmed during the year. We have the confirmed invoices paid during the year. That leads us to the confirmed obligations outstanding at the end of the year. So that's just an example. It doesn't have to be exactly like that, but that's an example that was provided by the ASU. The Guidance requires the buyer to consider the level of detail that would be necessary to satisfy the disclosure objective here, which is to "enable users of financial statements to understand the nature of activity during the period, changes from period to period, and the potential magnitude of the entity's supplier finance programs." In situations where you have a buyer that uses more than one supplier finance program, they can aggregate the disclosures, but not to the extent that the information gets obscured by programs that might have different characteristics. Importantly, this ASU doesn't affect any of the recognition, measurement, presentation of these obligations on the face of the balance sheet or in the statement of cash flows. It's all about disclosure of the information to provide more, again, transparency to these types of programs that are very, very common in certain industries.

**Ms. Grove Casey**

So when does this ASU become effective?

**Mr. Madray**

This one is effective for all entities for fiscal years that begin after December 15, 2022. It also includes interim periods within those fiscal years, except for that annual roll forward requirement, which is effective for fiscal years that begin after December 15, 2023. As with any type of ASU like this, early adoption would be permitted. With the exception of that disclosure of the roll forward information, which is only applied prospectively, entities will need to apply the amendments in this ASU retrospectively by providing those required disclosures for every period for which a balance

sheet is presented. During the first year of adoption, during that first fiscal year, information about the key terms of the programs and the balance sheet presentation need to be disclosed in each interim period. So it's a little tricky to get through that transition, but once it's in place, it will be, again, pretty much that roll forward of information every year will be the key component of that new requirement.

**Ms. Grove Casey**

Now let's look at ASU 2022-05, and that one is a relatively narrow scope topic, I think. It's on financial services related to insurance, which is in Topic 944, in particular, the transition for sold contracts. So could you give us an overview of that one?

**Mr. Madray**

Sure, that was issued in December 2022. The purpose of this one--as you rightly said, it's fairly narrow in scope--it's intended to reduce some cost and complexity associated with the adoption of some guidance related to long duration contracts. That guidance actually was issued in 2018. It was ASU 2018-12, which was targeted improvements to the accounting for long duration contracts. That phrase, 'targeted improvements for long duration contracts,' you'll often see abbreviated as LDTI, long duration targeted improvements. The amendments in that 2018 ASU required that an insurance entity apply a retrospective transition method as of the beginning of the earliest period presented, or beginning of the prior fiscal year if early application is selected. The FASB received some feedback that indicated that applying that LDTI guidance to contracts that were derecognized because of a sale or disposal of some individual or group of contracts or even legal entities before the effective date would not provide much useful information to investors and others, and could result in some significant challenges in applying that guidance to those sold contracts. Without the amendments in this current ASU, the insurance entity would be required to reclassify a portion of the previously recognized gains or losses from the sold contracts to that LDTI transition adjustment, because of the adoption of that new accounting standard. Because there's no effect on the insurance company's future cash flows, that reclassification really doesn't provide much useful information to investors or anyone else looking at those financial statements. The amendments in this current ASU will affect entities that have derecognized these types of contracts, sold them, before the LDTI effective date.

Now the LDTI effective dates we have on this slide, they're different for public business entities and for all others. For public business entities that meet the definition of an SEC filer that are not smaller reporting companies or SRCs, that transition or those targeted improvements are effective for fiscal years that began after December 15th, 2022, and interim periods within those fiscal years. Then, for everybody else, it's effective for fiscal years that began after December 15th, 2024, and interim periods within those fiscal years that began after December 15th, 2025. So, in a nutshell, this is intended to provide some relief for the transition to these targeted improvements for those contracts that have actually been sold before that effective date.

**Ms. Grove Casey**

So what exactly do the amendments do?

**Mr. Madray**

Well, essentially what they do is, they amend that LDTI transition guidance to allow insurance entities to make an accounting policy election. They can do this on a transaction-by-transaction basis. They can elect to exclude contracts that meet certain criteria from applying those amendments in that 2018 guidance. Now to qualify for that accounting policy election, as of that LDTI effective date, two conditions have to be met, which we have on this next slide. First, the insurance contracts must have been derecognized because of a sale or disposal of individual or group of contracts or legal entities. And, secondly, the entity has no significant continuing involvement with those derecognized contracts. As I mentioned earlier, that LDTI guidance currently is required to be applied retrospectively to the earliest period presented, or as of the beginning of the prior fiscal year if early application is elected. If that LDTI guidance was applied to contracts that have been derecognized before that LDTI effective date, those entities would have to communicate why previously recognized gains or losses have changed because of the adoption of a new accounting standard. Again, all parties involved agree that that really doesn't provide much useful information. As I said, the specifics are for those contracts that have been derecognized, typically by sale, an election can be made to exclude them from that retrospective adoption of that guidance.

**Ms. Grove Casey**

What about the effective date here?

**Mr. Madray**

These changes in this current ASU are the same as the effective dates for the LDTI guidance that we mentioned earlier in the previous slide. The one where it's different between public business entities that are not small reporting companies, essentially fiscal years begin after December 15, 2022, and for all others, essentially for those periods, those fiscal years again after December 15, 2024.

**Ms. Grove Casey**

So let's now take a look at ASU 2022-06. Now we talked about this topic a couple of years ago, and it relates to reference rate reform. Is this ASU related to that topic?

**Mr. Madray**

Yes, you're exactly right. It's directly related to what we discussed, I think, in 2020. This particular ASU was issued in December of 2022, and the title of it gives you a hint of what it's about, deferral of the sunset date of Topic 848. Essentially extends the period of time that the preparers can utilize that reference rate reform relief guidance. We'll talk about what all that is in just a moment. But in 2020, the FASB originally issued an ASU, 2020-04, which was facilitation of the effects of reference rate reform on financial reporting. It provided some optional guidance to ease the potential burden in accounting of reference rate reform on financial reporting. All of that related back to the London Interbank Offer Rate or LIBOR, as well as some other interbank offer rates that are widely used, have been widely used as a benchmark of reference rates around the world. In fact, there's trillions of dollars in loans and derivatives and other financial contracts that reference LIBOR, which is, essentially, the benchmark interest rate that banks use to make short-term loans to each other. Global markets have been moving away from LIBOR and other interbank offer rates toward rates that are more observable or transaction-based, less susceptible to manipulation. All of that led the FASB to launch a project in 2018 to address the potential that they expected would arise from a transition away from LIBOR.

**Ms. Grove Casey**

Let's talk a little bit about what led to that transition away from LIBOR and how the ASU impacts the related accounting.

**Mr. Madray**

Sure, LIBOR is essentially an average interest rate that's calculated through submissions of interest rates by major banks around the world. However, some folks may remember there was a scandal a number of years ago when it was discovered that banks were falsely inflating or deflating their rates so as to profit from trades or give the impression that they were more creditworthy than they actually were. For this to work, banks are supposed to submit the actual interest rates that they're paying or would expect to pay for borrowing from other banks, and therefore, LIBOR is supposed to be the total assessment of the health of the financial system because if the banks being polled feel confident about the state of things, they're going to report a low number. If a member bank feels a low degree of confidence in the financial system, they would report a higher interest rate number. Ultimately, in June of 2012, there were a number of criminal settlements by Barclays Bank that revealed some significant fraud and collusion by member banks that are connected to these rate submissions. Because LIBOR is used in the US derivatives market, any attempt to manipulate LIBOR is, essentially, an attempt to manipulate US derivative markets and would be a violation of US securities laws.

Pair that with the fact that mortgages, student loans, financial derivatives, all kinds of financial products, reference LIBOR, and the manipulation of those submissions used to calculate those rates could have a significant effect on individuals, businesses, financial markets all over the world. As a result of that manipulation and the scandal that went along with that, regulators around the world wanted to retire and transition away from LIBOR by the end of 2021. The intent was at that point, all dollar denominated loans, derivatives, debt and so on would have a new reference rate, typically the Secured Overnight Funding Rate or SOFR, which is an average of rates that market participants actually pay to borrow cash on an overnight basis using Treasuries as collateral. So that was what led to

the creation of that ASU, and ultimately, Topic 848 back in 2020. The objective of that guidance was to provide some relief during the temporary transition period, but it would not go on forever, so there was a sunset provision within Topic 848 based on the expectations of when LIBOR would cease being published. That was all well and good, but in 2021, the UK Financial Conduct Authority, or FCA, delayed the intended cease date of certain parts of LIBOR to June 30th of 2023. So with the best laid plans with a sunset of end of 2021, the FASB needed to go back and tinker with this just a bit, which is why we're talking about it again today.

**Ms. Grove Casey**

Yes, and so I'm assuming that this ASU delays the sunset date to coincide with when it actually stops being released.

**Mr. Madray**

Exactly. So that's exactly what this does. It extends it so that it covers the time where we're continuing to see a significant number of modifications that are taking place. It effectively defers the sunset date from December 31, 2022 to December 31, 2024. We expect that LIBOR would have completely ceased to exist, probably within this year, but certainly by that date. There continue to be modifications needed even beyond when LIBOR ceases to exist. So that's been extended to the end of 2024.

**Ms. Grove Casey**

This next ASU that we're going to look at is, I think, probably a clarification of some larger guidance that we had, which is related to leases in Topic 842. This one talks about common control leasing arrangements. Could you give us an overview of this new guidance?

**Mr. Madray**

Certainly, this is something, the first one that was issued in 2023, was in March of 2023. Common control arrangements and it's related to Topic 842 our lease accounting guidance. Essentially, the purpose of this is to clarify how related business entities that are controlled by the same owner are to deal with two issues: one, determining whether a lease exists; and two, accounting for leasehold improvements. So there's two parts to this. These are two big questions that came up quite a bit, especially in the private company community where you have a lot of common control arrangements. An owner of a business owns some real estate and leases the real estate to the business and any number of variations of that. So first the practical expedient deals with determining whether a lease exists. You have to remember that Topic 842 requires that entities determine whether a related party arrangement between entities under common control is a lease. If that arrangement is determined to be a lease, then an entity has to classify and account for the lease on the same basis as an arrangement with an unrelated party, which is, essentially, on the basis of the legally enforceable terms and conditions. Again, private companies were struggling with this because determining enforceable terms and conditions in a common control arrangement could be difficult. Specifically, private companies were saying that determining the enforceable terms could necessitate obtaining a formal legal opinion in some cases, which could be challenging because of the common control nature of the arrangement. And that's even saying if those are written arrangements, if there are oral agreements, again, [it's] even more difficult. So this ASU provides a practical expedient so that private companies and not-for-profit entities, not-for-profits that are not conduit bond obligators, they can focus and use only the written terms and conditions of the common control arrangement to determine, one, whether a lease exists, and two, the classification and accounting for that lease. So it's either an operating lease or a finance lease.

Under this practical expedient, entities are not required to determine whether the written terms and conditions are enforceable when applying that practical expedient and can apply that on an arrangement-by-arrangement basis. If the lease is verbal, the company would need to document the existing unwritten terms in order to apply the lease accounting rules. So this practical expedient is only applicable to written leases. But it does, again, give especially private or smaller companies, the ability to focus just on the written terms and arrangements and not have to make some kind of determination of whether they are actually enforceable in these cases. That is, essentially, what the practical expedient is all about in the ASU.

**Ms. Grove Casey**

You also mention leasehold improvements. How does this ASU impact the accounting for those? Because sometimes there's more money tied up there than there is in the actual rent.



**Mr. Madray**

That is true. Topic 842 generally requires that leasehold improvements have an amortization period that's consistent with either the shorter of the remaining lease term or the useful life of those particular leasehold improvements. Lessees would recognize leasehold improvements when they are the actual accounting owner of those improvements. Once again, private companies pointed out that amortizing leasehold improvements in arrangements between entities under common control over a period shorter than the expected useful life of those leasehold improvements didn't really match the economics of those leasehold improvements, especially if it was a common control lease with a short lease term. Private companies further noted that the accounting, depending on the salvage value that's assigned to the leasehold improvements, could fail to recognize the transfer of the value between the entities under common control when the lessee no longer controls the use of that underlying asset. The amendments in this ASU will require that leasehold improvements in a common control lease be accounted for as you see on this next slide. First, it's amortized by the lessee over the useful life of the leasehold improvements to the common control group. That's regardless of the lease term, as long as the lessee controls the use of that underlying asset through a lease. However, if the lessor obtained the right to control the use of that underlying asset through a lease with another entity that's not within the same common control group, then the amortization period would not exceed the amortization period of that common control group. Secondly, the leasehold improvements are accounted for as a transfer between entities under common control through an adjustment to equity, or if it's a not-for-profit, it would be an adjustment to net assets if and when that lessee no longer controls the use of that underlying asset. So two things addressing specifically some issues within the private company community where these common control arrangements are seen very, very frequently.

**Ms. Grove Casey**

When will these amendments become effective?

**Mr. Madray**

This one is effective for fiscal years that begin after December 15, 2023. Either part can be early adopted in interim or annual financial statements that have not yet been made available for issuance. If an entity does adopt the amendments in an interim period, it needs to adopt them as of the beginning of the fiscal year that includes that interim period. I suspect a number of companies will adopt these amendments early to be able to apply the new guidance that will make things a bit easier for these types of common control arrangements.

**Ms. Grove Casey**

The last ASU that we want to take a look at right now is ASU 2023-02 and it relates to investments, equity method and joint venture. So could you give us a brief overview of this new guidance?

**Mr. Madray**

Sure, this one was issued in March of 2023. It's essentially accounting for investments in tax credit structures using the proportional amortization method. The purpose of this is to improve the accounting and disclosures for investments in tax credit structures, obviously. This came out of the Emerging Issues Task Force (EITF). Essentially, it allows reporting entities to elect to account for qualifying tax equity investments using the proportional amortization method, regardless of the type of program that gave rise to those related investment tax credits. Previously or prior to this ASU, entities could apply that proportional amortization method, only to qualifying tax equity investments in low-income housing credit structures. That led to folks in recent years to ask the FASB to extend that method to qualify tax equity investments that generate tax credits through other programs. Again, the EITF addressed the issue and decided that it should be expanded to include other tax equity investments from other types of tax credit programs.

**Ms. Grove Casey**

And when do these amendments become effective?

**Mr. Madray**

This is effective for public business entities for fiscal years that began after December 15th of 2023. For all other entities, it's effective a year later, years beginning after December 15th, 2024. But of course, with something like this, as is always the case, early adoption is permitted. I suspect folks that were requesting this guidance would move towards adopting it even before it is effective to give a better presentation of the accounting for tax credit programs.

## SUPPLEMENTAL MATERIALS

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### FASB Update

by J. Russell Madray, CPA, CGMA

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#### Overview

In September 2022, the FASB issued ASU 2022-04, *Disclosure of Supplier Finance Program Obligations*, to enhance transparency about an entity's use of supplier finance programs. Under the ASU, the buyer in a supplier finance program is required to disclose information about the key terms of the program, outstanding confirmed amounts as of the end of the period, a roll-forward of such amounts during each annual period, and a description of where in the financial statements outstanding amounts are presented.

When an entity purchases goods or services on credit from a supplier, a trade payable arises for the invoice amount owed to the supplier. Sometimes the buyer enters into an arrangement with a bank or other intermediary under which the intermediary offers to purchase the receivables held by the supplier. Such arrangements are known by various names, such as "structured payable arrangements," "vendor payable programs," "open account structured vendor payable programs," "reverse factoring," "supplier finance," or "supplier-chain finance." Typically, the arrangement gives suppliers the option to settle trade receivables by obtaining a payment from the intermediary either (1) before the invoice due date at a discounted amount or (2) on the invoice due date for its full amount.

Depending on their terms, supplier finance programs offer the parties various potential benefits, such as:

- The ability of suppliers to monetize trade receivables and reduce the associated credit exposure—by selling their trade receivables to an intermediary, suppliers can receive payment before the invoice due date and reduce their credit exposure
- The ability of buyers of goods or services to obtain extended payment terms—suppliers may be more willing to offer extended payment terms to buyers of their goods or services if they can obtain early payment from intermediaries. Further, intermediaries may offer buyers extended payment terms
- The ability of intermediaries to benefit from early-payment discounts, rebates, and transaction fees and charges—intermediaries earn a spread on the basis of the relationship between their funding costs and the amount of early-payment discounts, rebates, and other fees and charges received from suppliers
- Operational benefits—because of an intermediary's involvement, the arrangement may enhance the processing, administration, and control of the associated payments for buyers and suppliers
- An extended early-payment discount period—if an intermediary pays a supplier within the period during which the supplier offers an early-payment discount (e.g., a 2 percent discount for payment within 10 days of an amount due in 30 days, or "2/10 net 30"), the intermediary may offer the buyer a discount on the amount due for an extended period (e.g., a 1 percent discount for payment within 10 days of an amount due in 60 days, or "1/10 net 60")
- A reduction of the amount due or other similar rebate—the intermediary may offer the buyer a reduction of the amount due or a reimbursement of part of the amount paid on the basis of net amounts paid to suppliers (a supplier may agree to pay the intermediary a fee or reduce the amount due because of benefits it receives from the arrangement, such as a lowered credit risk exposure on the amount due or earlier payment of such amount)

#### Main Provisions

ASU 2022-04 requires the buyer in a supplier finance program to disclose qualitative and quantitative information about the program. Such a program is defined as an arrangement that has all of the following characteristics:

- a. An entity enters into an agreement with a finance provider or an intermediary

- b. The entity confirms supplier invoices as valid to the finance provider or intermediary under the agreement described in (a)
- c. The entity's supplier has the option to request early payment from a party other than the entity for invoices that the entity has confirmed as valid

At a minimum, the buyer in a supplier finance program is required to disclose the following information at least annually:

- The key terms of the program, including payment terms and assets pledged as security or other forms of guarantees
- The amount of obligations outstanding at the end of the reporting period that the buyer has confirmed as valid and:
  - A description of where those obligations are presented in the balance sheet (if the obligations are included in more than one line item, the amount in each line item must be disclosed)
  - Roll-forward information for the annual period showing the amount at the beginning of the period, the amount added during the period, the amount settled during the period, and the amount outstanding at the end of the period

Further, in each interim reporting period, the buyer must disclose the outstanding confirmed amount as of the end of the interim period. The example below, which is reproduced from Accounting Standards Codification (ASC) 405-50-55-4 and 55-5 (added by the ASU), illustrates the disclosure of roll-forward information.

**Example: Disclosure of a Rollforward of Obligations Confirmed as Valid Under a Supplier Finance Program**

The roll-forwards of Entity A's outstanding obligations confirmed as valid under its supplier finance program for years ended December 31, 20X2, and 20X1, are as follows (in thousands):

	<b>20X2</b>	<b>20X1</b>
Confirmed obligations outstanding at the beginning of the year	\$ 733	\$ 712
Invoices confirmed during the year	2,435	2,278
Confirmed invoices paid during the year	<u>(2,315)</u>	<u>(2,257)</u>
Confirmed obligations outstanding at the end of the year	\$ 853	\$ 733

The ASU requires the buyer to "consider the level of detail necessary to satisfy the disclosure objective," which is "to enable users of financial statements to understand the nature, activity during the period, changes from period to period, and potential magnitude of the entity's supplier finance programs." A buyer that uses more than one supplier finance program "may aggregate disclosures, but not to the extent that useful information is obscured by the aggregation of programs that have substantially different characteristics." The ASU does not affect the recognition, measurement, or presentation of supplier finance program obligations on the face of the balance sheet or in the cash flow statement.

### Effective Date and Transition

The amendments in ASU 2022-04 are effective for all entities for fiscal years beginning after December 15, 2022, including interim periods within those fiscal years, except for the disclosure of roll-forward information, which is effective for fiscal years beginning after December 15, 2023. Early adoption is permitted.

With the exception of the amendment on disclosure of roll-forward information, which entities only need to apply prospectively, entities must apply the amendments in the ASU retrospectively by providing the required disclosures for each period for which a balance sheet is presented. During the fiscal year of adoption, information about the key terms of the programs and the balance sheet presentation of the program obligations must be disclosed in each interim period.

**ASU 2022-05, *Financial Services—Insurance (Topic 944), Transition for Sold Contracts*****Overview**

In December 2022, the FASB issued ASU 2022-05, *Financial Services—Insurance (Topic 944), Transition for Sold Contracts*, to reduce implementation costs and complexity associated with the adoption of the transition guidance for long duration contracts (LDTI). In August 2018, the FASB issued ASU 2018-12, *Financial Services—Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts (LDTI)*. The amendments in ASU 2018-12 require that an insurance entity apply a retrospective transition method as of the beginning of the earliest period presented or the beginning of the prior fiscal year if early application is elected. The FASB received stakeholder feedback indicating that applying the LDTI guidance to contracts that were derecognized because of a sale or disposal of individual or a group of contracts or legal entities before the LDTI effective date likely would not provide decision-useful information to investors and other allocators of capital and may result in significant operability challenges for insurance entities to apply the guidance. Without the amendments in this ASU, an insurance entity would be required to reclassify a portion of the previously recognized gains or losses to the LDTI transition adjustment because of the adoption of a new accounting standard. Because there is no effect on an insurance entity's future cash flows, such a reclassification may not be decision useful to investors and other allocators of capital.

The amendments in this ASU affect insurance entities that have derecognized contracts before the LDTI effective date. The LDTI effective dates are as follows:

- For public business entities that meet the definition of a U.S. Securities and Exchange Commission (SEC) filer and are not smaller reporting companies, LDTI is effective for fiscal years beginning after December 15, 2022, and interim periods within those fiscal years. Early application is permitted.
- For all other entities, LDTI is effective for fiscal years beginning after December 15, 2024, and interim periods within fiscal years beginning after December 15, 2025. Early application is permitted.

**Main Provisions**

The amendments in this ASU amend the LDTI transition guidance to allow an insurance entity to make an accounting policy election on a transaction-by-transaction basis. An insurance entity may elect to exclude contracts that meet certain criteria from applying the amendments in ASU 2018-12. To qualify for the accounting policy election, as of the LDTI effective date both of the following conditions must be met:

- The insurance contracts must have been derecognized because of a sale or disposal of individual or a group of contracts or legal entities
- The entity has no significant continuing involvement with the derecognized contracts

Currently, the LDTI guidance is required to be applied retrospectively to the earliest period presented or as of the beginning of the prior fiscal year if early application is elected. If the LDTI guidance was applied to contracts that have been derecognized before the LDTI effective date, preparers would have to communicate why previously recognized gains or losses have changed because of the adoption of a new accounting standard. In the FASB's view, that likely would not have provided decision-useful information to investors and others.

**Effective Date and Transition**

The effective dates of the amendments in this ASU are consistent with the effective dates of the amendments of LDTI, mentioned above.

**ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848*****Overview**

In December 2022, the FASB issued ASU 2022-06, *Reference Rate Reform (Topic 848): Deferral of the Sunset Date of Topic 848*, that extends the period of time preparers can utilize the reference rate reform relief guidance. In 2020,

the FASB issued ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*, which provides optional guidance to ease the potential burden in accounting for (or recognizing the effects of) reference rate reform on financial reporting. The London Interbank Offered Rate (LIBOR) and other interbank offered rates are widely used benchmark or reference rates in the United States and globally. Trillions of dollars in loans, derivatives, and other financial contracts reference LIBOR, the benchmark interest rate banks use to make short-term loans to each other. With global capital markets expected to move away from LIBOR and other interbank offered rates toward rates that are more observable or transaction based and less susceptible to manipulation, the FASB launched a broad project in late 2018 to address potential accounting challenges expected to arise from the transition.

LIBOR is an average interest rate calculated through submissions of interest rates by major banks across the world. However, a scandal arose in 2008 when it was discovered that banks were falsely inflating or deflating their rates so as to profit from trades, or to give the impression that they were more creditworthy than they were. Banks are supposed to submit the actual interest rates they are paying, or would expect to pay, for borrowing from other banks. LIBOR is supposed to be the total assessment of the health of the financial system because if the banks being polled feel confident about the state of things, they report a low number and if the member banks feel a low degree of confidence in the financial system, they report a higher interest rate number. In June 2012, multiple criminal settlements by Barclays Bank revealed significant fraud and collusion by member banks connected to the rate submissions.

Because LIBOR is used in US derivatives markets, an attempt to manipulate Libor is an attempt to manipulate US derivatives markets, and thus a violation of American law. Since mortgages, student loans, financial derivatives, and other financial products often rely on LIBOR as a reference rate, the manipulation of submissions used to calculate those rates can have significant negative effects on consumers and financial markets worldwide.

As a result of the scandal, regulators wanted to retire LIBOR with a full phase-out by the end of 2021. At that point, all dollar-denominated loans, derivatives and debt would have referenced a new rate—the Secured Overnight Funding Rate (SOFR)—which is a median of rates that market participants pay to borrow cash on an overnight basis, using Treasuries as collateral.

### **Main Provisions**

The objective of the guidance in ASC 848 is to provide relief during the temporary transition period, so the FASB included a sunset provision within ASC 848 based on expectations of when LIBOR would cease being published. In 2021, the UK Financial Conduct Authority (FCA) delayed the intended cessation date of certain parts of LIBOR to June 30, 2023.

To ensure the relief in ASC 848 covers the period of time during which a significant number of modifications may take place, ASU 2022-06 defers the sunset date of ASC 848 from December 31, 2022, to December 31, 2024, after which entities will no longer be permitted to apply the relief in ASC 848.

### **ASU 2023-01, *Leases (Topic 842) Common Control Arrangements***

#### **Overview**

In March, the FASB issued ASU 2023-01, *Leases (Topic 842) Common Control Arrangements*, to clarify how related business entities that are controlled by the same owner are to approach: 1) determining whether a lease exists; and 2) accounting for leasehold improvements.

#### **Practical Expedient**

ASC 842, *Leases*, requires that entities determine whether a related party arrangement between entities under common control (common control arrangement) is a lease. If the arrangement is determined to be a lease, an entity must classify and account for the lease on the same basis as an arrangement with an unrelated party (i.e., on the basis of legally enforceable terms and conditions). Private company stakeholders observed that determining the enforceable

terms and conditions of a common control arrangement to apply ASC 842 often is difficult and costly. Specifically, private company stakeholders stated that determining the enforceable terms and conditions of those arrangements could necessitate obtaining a formal legal opinion in certain cases, which could be challenging because of the common control nature of the arrangement (even for written arrangements). The amendments in this ASU provide a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement to determine:

1. Whether a lease exists
2. The classification of and accounting for that lease

Entities are not required to determine whether written terms and conditions are enforceable when applying the practical expedient and may apply the practical expedient on an arrangement-by-arrangement basis. If the lease is verbal, the company must document the existing unwritten terms in order to apply lease accounting rules. The practical expedient is only applicable for written leases.

### **Leasehold Improvements**

ASC 842 generally requires that leasehold improvements have an amortization period consistent with the shorter of the remaining lease term and the useful life of the improvements. Lessees recognize leasehold improvements when they are the accounting owner of those improvements. Private company stakeholders noted that amortizing leasehold improvements associated with arrangements between entities under common control determined to be leases (common control leases) over a period shorter than the expected useful life of the leasehold improvements may result in financial reporting that does not faithfully represent the economics of those leasehold improvements, particularly in common control leases with short lease terms. Those stakeholders further noted that this accounting, depending on the salvage value assigned to the leasehold improvements, may fail to recognize the transfer of value between the entities under common control when the lessee no longer controls the use of the underlying asset.

The amendments in this ASU require that leasehold improvements associated with common control leases be:

1. Amortized by the lessee over the useful life of the leasehold improvements to the common control group (regardless of the lease term) as long as the lessee controls the use of the underlying asset (the leased asset) through a lease. However, if the lessor obtained the right to control the use of the underlying asset through a lease with another entity not within the same common control group, the amortization period may not exceed the amortization period of the common control group.
2. Accounted for as a transfer between entities under common control through an adjustment to equity (or net assets for not-for-profit entities) if, and when, the lessee no longer controls the use of the underlying asset.

### **Effective Date and Transition**

The amendments in ASU 2023-01 are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been made available for issuance. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

### **ASU 2023-02, Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method**

#### **Overview**

In March 2023, the FASB issued ASU 2023-02, *Investments—Equity Method and Joint Ventures (Topic 323): Accounting for Investments in Tax Credit Structures Using the Proportional Amortization Method*, that is intended to improve the accounting and disclosures for investments in tax credit structures. The ASU is a consensus of the

FASB's Emerging Issues Task Force (EITF). The ASU allows reporting entities to elect to account for qualifying tax equity investments using the proportional amortization method, regardless of the program giving rise to the related income tax credits.

Reporting entities were previously permitted to apply the proportional amortization method only to qualifying tax equity investments in low-income housing tax credit (LIHTC) structures. In recent years, stakeholders asked the FASB to extend the application of the proportional amortization method to qualifying tax equity investments that generate tax credits through other programs, which resulted in the EITF addressing this issue.

### **Effective Date and Transition**

For public business entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted for all entities in any interim period.

## **GROUP STUDY MATERIALS**

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### **A. Discussion Problems**

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1. Describe the disclosure requirements for a buyer in a supplier finance program.
2. What is LIBOR? Why are the U.S. and other countries transitioning to other reference rates?
3. Discuss the practical expedient in ASU 2023-01, related to leases, that is available to private companies and certain not-for-profit organizations.



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**B. Suggested Answers to Discussion Problems**

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1. At a minimum, the buyer in a supplier finance program is required to disclose the following information at least annually:
  - The key terms of the program, including payment terms and assets pledged as security or other forms of guarantees
  - The amount of obligations outstanding at the end of the reporting period that the buyer has confirmed as valid and:
  - A description of where those obligations are presented in the balance sheet (if the obligations are included in more than one line item, the amount in each line item must be disclosed)
  - Roll-forward information for the annual period showing the amount at the beginning of the period, the amount added during the period, the amount settled during the period, and the amount outstanding at the end of the period

Further, in each interim reporting period, the buyer must disclose the outstanding confirmed amount as of the end of the interim period.

2. LIBOR (London Interbank Offered Rate) is an average interest rate calculated through submissions of interest rates by major banks across the world. However, a scandal arose in 2008 when it was discovered that banks were falsely inflating or deflating their rates so as to profit from trades, or to give the impression that they were more creditworthy than they were. Banks are supposed to submit the actual interest rates they are paying, or would expect to pay, for borrowing from other banks. LIBOR is supposed to be the total assessment of the health of the financial system because if the banks being polled feel confident about the state of things, they report a low number and if the member banks feel a low degree of confidence in the financial system, they report a higher interest rate number. In June 2012, multiple criminal settlements by Barclays Bank revealed significant fraud and collusion by member banks connected to the rate submissions. As a result of the scandal, regulators want to retire LIBOR with a full phase-out by the end of 2021. At that point, all dollar-denominated loans, derivatives and debt will reference a new rate—the Secured Overnight Funding Rate (SOFR)—which is a median of rates that market participants pay to borrow cash on an overnight basis, using Treasuries as collateral.
3. The amendments in this ASU provide a practical expedient for private companies and not-for-profit entities that are not conduit bond obligors to use the written terms and conditions of a common control arrangement to determine:
  - Whether a lease exists
  - The classification of and accounting for that lease

Entities are not required to determine whether written terms and conditions are enforceable when applying the practical expedient and may apply the practical expedient on an arrangement-by-arrangement basis. If the lease is verbal, the company must document the existing unwritten terms in order to apply lease accounting rules. The practical expedient is only applicable for written leases.

## PART 2. AUDITING

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### Transition Issues with SAS 145

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Beginning with calendar year 2023 audits, auditors will need to apply new concept on risk assessment. While inherent risk remains an essential part of the assessment process, SAS 145 made some changes to improve audit effectiveness. Part of the changes relate to the understanding of an entity's internal control and assessing control risk.

For more on the changes, and the challenges, in transitioning to SAS 145, 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 a new standard and our roadblocks in transitioning to that standard, and that is SAS 145. To begin, let's talk about what SAS 145 is and when does it become effective?

#### **Ms. Louis**

It is effective for the audits of your financial statements for periods ending on or after December 15, 2023. So, really, starting with your calendar year-end 2023 audits, going forward. The goal of this is to re-look at the section of the general accepted auditing standards that deals with understanding the entity and its environment, and assessing risk of material misstatement. Ultimately, it is meant to provide guidance in how to improve the quality of engagements through revisiting what those requirements are within that section of the codified standards.

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

Is this a rewrite of the audit risk model?

#### **Ms. Louis**

It is not a rewrite; it is still going to apply the basic audit risk model with inherent risk, control risk, and detection risk. What it is meant to do is to get better application of the model to have it be a more thought-based process. Also, to get more consistency in the information that is gathered in order to form conclusions about the design of the nature, timing, and extent of the actual procedures that you are doing on a given audit.

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

Inherent risk is a fundamental concept in the audit risk model. What is an enhancement that was made to get better application of that concept?

#### **Ms. Louis**

One of the things that you will see is that a lot of the enhancements with SAS 145 focused on this inherent risk element to reduce diversity in practice and better explain what it is meant to be. In order to accomplish that, one of the things was that SAS 145 introduced the term "inherent risk factor." I think we have always had factors that we considered related to inherent risk so this might not be a mind-blowing change. It does emphasize that thinking about these factors is what is intended to guide the auditor towards a risk assessment that makes sense. They are trying to assess risks so that I can analyze how I should respond to this identified risk through my detailed audit plan. The inherent risk factors are factors that I consider in order for me to come up with my inherent risk assessment.

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

What would you say are some of the key points to fully understand the inherent risk concept?

**Ms. Louis**

The inherent risk is meant to be the susceptibility of a specific assertion within a class of transactions, account, or disclosure where misstatement could be material. Now, it could be material individually, it could be material when aggregated with other stuff, but an important part that they have kept there is that the susceptibility is before the consideration of any related controls. So, it is related to a specific assertion within a particular account, class of transactions, or disclosure, and it is based on a likelihood or a magnitude of an issue that I am worried about as we are trying to put together our assessment of risk of material misstatement.

It is important that just because an assertion might be easy to audit, like the existence of cash, doesn't necessarily mean that inherent risk is low. In essence, inherent risk comes from the nature of the transaction or the nature of the event.

**Ms. Grove Casey**

Would you say that one way to think about inherent risk is to say that it is a risk posed to the financial statements being misstated that is not due to a failure in the system of internal control?

**Ms. Louis**

That is what they are intending. When they say before consideration of controls, is there something about this area that causes you to be concerned? So, I can't necessarily say that [because] cash is kept in a bank, or it is counted every day, that makes the inherent risk of cash low; both of those are counting on a control (that it is kept in a bank, or I count it every day). Those are safeguarding-type controls that are important for me to understand as I am assessing risk of material misstatement. But inherently, what might make cash low risk is that it is in a savings account where the nature of the account is just to earn a rate of return. I might be adding to my savings, but I am not using it for regular disbursements.

A payroll imprest account would be, by its nature, less risky than, say, an operating account that is capturing all of my cash receipts and disbursements, predominantly. So, I can look at the nature of a cash account and say, "I don't think that that carries as much inherent risk," but I do need to think about the inherent risk factors: complexity, subjectivity, volume of activity, history of misstatement, and competency of people doing it. I do need to think about all those factors as I am making considerations about where do I want [to assess] inherent risk. Where does my gut tell me that there is a greater likelihood of having problems here, relative to other aspects of these financial statements?

**Ms. Grove Casey**

What else did SAS 145 clarify as it relates to inherent risk?

**Ms. Louis**

Just that we do want to think about inherent risk not just quantitatively, but qualitatively. As I mentioned, if it is an area that has complex accounting or it has a lot of subjectivity that could be influenced by a bias on the part of management, or if we have had a lot of changes in that area. If there are fraud risks—like the fact that there may be risk with journal entries—I might think about journal entry testing as it is a higher-risk area for me. So, we do need to think about quantitative and qualitative factors that, by their nature, as we think about the susceptibility of this area, this assertion to problems, I really should think about those problems.

**Ms. Grove Casey**

What might make an inherent risk factor be higher for qualitative reasons?

**Ms. Louis**

Well, I mentioned, in concept, a couple. If there is a lot of complexity, [for example] if it is related to a derivative; it could be that it is a significant estimate, so it is more susceptible to management bias; it could be [something] like a warranty reserve; it could be that it relates to something that is affected by inflation or increased interest rates or gas

prices; it could be something related to the entity, its environment, and changes that could have a reflection on the preparation and fair presentation of information; it could be a lawsuit that might have a lot of uncertainty about what the actual outcome is going to be, even though we think it is probable to have a negative outcome. Those are all things, as we think about inherent risk, where something might have more inherent risk to it. So, if something is significant there is some level of risk that there could be problems, but where do I think that inherent risk, ultimately, might be greater?

**Ms. Grove Casey**

Is an auditor still required to assess risk at the relevant assertion level?

**Ms. Louis**

They are. That had been the requirement, and it continues to be the requirement. In the end, as we look at a relevant assertion, an assertion means it is relevant because there is this reasonable possibility that individually or in the aggregate, there could be something material here. So, I am saying it is relevant as far as me thinking about my risk. And since it is relevant, I now have to figure out, for this relevant thing, as I consider the inherent risk factors, where do I think my inherent risk is on a relative scale of bigger issue versus smaller issue, potentially?

**Ms. Grove Casey**

Can you give an example of how assertion level risk is applied?

**Ms. Louis**

Sure. If we are thinking about an area like accounts payable, as I look at understanding the entity and the environment and other factors, I might determine that I think that the inherent risk of the overstatement of my payables (the existence) is relatively low, but I am more concerned about understatement. So, I make the completeness assertion high risk and the existence assertion low risk because, just inherently, what is more possible to occur that could be a material issue? The understatement of my liabilities is often a bigger risk and concern compared to overstatement of those liabilities.

**Ms. Grove Casey**

Can you give an example of how assertion level risk is applied?

**Ms. Louis**

There are other cases where you also are looking at, say, your revenues, and while we may have been concerned about the completeness of the liabilities and the expenses, I probably would be more worried about the overstatement (the existence) of a revenue and maybe a related receivable. Do I believe, at an assertion level, that overstatement or understatement is the bigger concern? I would try to reflect that through looking at the specific assertions and making different judgment calls about each assertion that is related to a given account, class of transactions, or disclosure.

**Ms. Grove Casey**

Would you say that identifying relevant assertions is critical for an effective and efficient audit?

**Ms. Louis**

I absolutely would agree with that statement, and I think that this SAS is meant to reflect that. We do need to ensure [it], because this is based on our judgment. It is the auditor's or the engagement team's gut instincts about where they think there is a greater probability of having issues—and that are material.

The engagement team, as a whole, should all be involved in making sure that we have properly made judgments about these inherent risk factors, because I don't want to over-audit and spend more time on something that I don't have to, but I also don't want to under-audit and do less work than is needed in the circumstances. To be both effective and efficient, the inherent risk component is probably the most important component for me to assess as it relates to the application of the audit risk model.

**Ms. Grove Casey**

How does identifying relevant assertions lead to the design of the detailed audit plan?

**Ms. Louis**

If I have an area where there are one or more relevant assertions, we said there is an assertion here and it is at least reasonably possible that there is something here that we care about, that is making that related—that assertion relates to cash, or relates to revenue, or relates to liabilities. That assertion, now, for that account, class of transactions, or disclosure, is going to merit having an audit program step.

So, if there are one or more relevant assertions, there is something that I am going to have to do [in the] detection risk component to address that risk that I have identified through the planning risk assessment phase.

**Ms. Grove Casey**

Does every account that is material quantitatively have a relevant assertion?

**Ms. Louis**

Well, that is an area where there could be some professional judgment about that. An example that comes up sometimes in a very small-entity environment is that they may have property, plant, and equipment (PP&E), but they don't have a lot of additions and disposals each year. [Such as], I have a building that is sitting on the books and the balance is material because I have had this building for the last ten years and I might say, "While PP&E is material, is there really a risk that there could be material misstatement there?" Now, I do have to think about all the assertions. Maybe impairment of the building is a concern with valuation. So, it is not just existence, completeness, and cutoff. There are other things; there could be disclosures that make that area relevant.

You just need to be careful that if you are making a judgment call that this audit area does not merit a detailed audit plan, then you need to be able to justify it. Documentation of your thought process and your logic is going to be important as you are trying to lay out your logic in how it is that you linked your risk assessments to the procedures that you are actually going to do.

**Ms. Grove Casey**

How does an auditor flag the highest risks on an audit under the new standard?

**Ms. Louis**

Those risks that would be at the highest end of your risks would be your significant risks. They are saying these areas are at the upper end of your risk spectrum, where they are going to have the greatest likelihood of a material issue. It is possible that there are issues of some concern at the low end of my risk scale. Then, there are things that are probable to be material at the upper end of my risk scale—and those things are deemed to be significant risks.

**Ms. Grove Casey**

Is there still a requirement to give significant risks special audit consideration?

**Ms. Louis**

They don't use those words underneath the new standards, and you still want to make sure that you are getting your most persuasive audit evidence related to your highest risks. So, ultimately, you are getting more persuasive evidence through stronger procedures when you are dealing with the risk that is at the higher end of your spectrum of inherent risk.

**Ms. Grove Casey**

Talk to me more about the concept of having a "spectrum of inherent risk."

**Ms. Louis**

The goal is to think about a sliding scale of risk. There are things that are relevant to audit, but I don't have to do a whole lot of work to get sufficient and appropriate evidence about them. There are going to be other areas where the risk is greater, and my spectrum of risk is putting it at the upper end of the spectrum where maybe I do need to send confirmations and observe the inventory. I might need to do a lot of detail testing using sampling and other applications.

So, if we think about the nature, the timing, and the extent of my work, they are saying that when something is relevant, you are going to do something for that significant account, class of transactions, or disclosure. Now, you have to figure out what would be sufficient and appropriate given varying levels of risk that exist, and to alter your audit evidence to get more persuasive evidence in areas of higher risk, and being okay with having less persuasive evidence in areas of lower risk.

**Ms. Grove Casey**

Is it specified how a firm needs to designate the scalability of inherent risk?

**Ms. Louis**

They don't specify it; various audit methodologies do different things. It might be in a scale of low, medium, high, or it might be using some sort of numeric scale. It doesn't specify how you do it, but there does need to be a sense of scalability. There do need to be different categorizations of low to super-high risk and variations in between that could guide the practitioner in documenting their conclusions about risks so that we can make sure that we are designing our detailed audit plan accordingly.

**Ms. Grove Casey**

Are certain risks always significant?

**Ms. Louis**

Well, within certain sections of the audit standards, they may flag things as being always significant, like revenue recognition risk being presumed to be high risk, management override, and some things related to related-party transactions that are significant. There are going to be some aspects of things that they are going to presume to be areas that you will pay more attention to as you are looking at how to allocate your time on a given audit engagement. It may not be within this particular audit section. It could be that they are laying that out in other areas of the generally accepted auditing standards (GAAS).

**Ms. Grove Casey**

Are smaller entities always lower risk?

**Ms. Louis**

The size of the entity is a factor, but you also have to look at the nature of the entity and the complexity of the entity. Sometimes, a larger entity has less risk than a smaller entity, given the industry that they are functioning in and the nature of their transactions and events. So, they want to make sure that you don't purely look at the size of the entity alone as you are determining what an appropriate audit response might be.

**Ms. Grove Casey**

It seems like having a sound understanding of the entity and its environment would be important to doing a proper risk assessment. Would you agree?

**Ms. Louis**

It is important and that is part of why, in this new SAS 145, they talk about how I do need to use what I know about the entity, its environment, its industry, how the economy affects it, how they are financed, who are the readers of

the financials, and what are they looking at as they look at these financials to make economic decisions? We really do need to understand all those things so that I can help do a better job at knowing what inherent risk factors might be relevant to these financial statements that I am looking at.

**Ms. Grove Casey**

How did the new SAS impact an auditor's responsibilities for evaluating the design of internal controls?

**Ms. Louis**

It really didn't change the responsibility, fundamentally, it just clarified that you are understanding a system of internal controls. As we think about the *COSO Internal Control—Integrated Framework*, for example, with the control environment, the risk assessment process, monitoring, information and communication, and control activities, some of those elements will directly affect the financial statements, like having a control activity to process a disbursement. Or it could be something that indirectly affects the fair presentation of the financials because it is establishing the control consciousness of the organization, and having accountability and oversight of the financial reporting process. So, the system of internal controls is important to understand as it is giving me more information on which I can better have a basis for making judgments about where to spend my time.

**Ms. Grove Casey**

While it was common practice before, I understand that the new SAS requires a separate assessment of inherent and control risk. Why do you think they decided to make this explicit in the new standard?

**Ms. Louis**

Well, part of it is because they say, explicitly, that if your control risk is left at high or the maximum, that your risk of material misstatement will be what your inherent risk is. I think that they wanted to highlight how important the inherent risk component is by explicitly requiring you to segregate it from control risk, because I can only ultimately reduce control risk if I am actually testing the operating effectiveness of controls.

A lot of times, auditors do assess control risks at high or the maximum because they don't feel it necessary to test controls; they wouldn't benefit from it in any efficiency way, so they decide to leave it alone. Taking a purely substantive approach will continue to be an option or a choice in appropriate circumstances. I think that the separate assessment, as I said, was meant to just really highlight how the inherent risk determination is really an important driving factor in your overall risk assessment, particularly if you are not going to take a control reliance strategy.

**Ms. Grove Casey**

If you leave control risk at the maximum, does what you know about internal controls even matter in the risk assessment process?

**Ms. Louis**

Well, that is certainly something to ponder, and in the end, they did say that you still need to use what you know about controls as you are influencing your determination about your substantive procedures. So, as I made determinations about whether to do interim work, or should I be sending a confirmation, or is there a document I can inspect, if I don't understand the area or understand the system of controls—including the control activities on how I initiate, authorize, process, record, reconcile, and report stuff [those determinations are more difficult]. It makes it easier for you to put together an audit plan knowing these things.

Now, it also says that if you are aware of a deficiency in controls, you do have to build that into your risk assessment. Knowing, even in just the design of the system, that there is a flaw or an issue, it is going to have an effect on how I put together my detailed audit program.

**Ms. Grove Casey**

How did the new standard enhance requirements related to the auditor's maintenance of professional skepticism?

**Ms. Louis**

Related to professional skepticism, it is important that there always is an open, questioning mind, and that we have a robust conversation about risk and response within our engagement team discussions. When we have contradictory, inconsistent evidence, we look at resolving those inconsistencies in order to have sufficient and appropriate evidence. The key is that they would say it is necessary for you to look at the audit evidence that you are gathering from beginning to end in the audit in an unbiased way. Make sure that you are thinking about, as I gather information, as I gather evidence, is that consistent with what I thought about risk? Part of that is to make sure that I am adapting accordingly. I may have made preliminary determinations about what to do but, as I get more and better information, it might alter my overall plan.

**Ms. Grove Casey**

What is one of the ways that an auditor can demonstrate that professional skepticism was maintained?

**Ms. Louis**

There is a requirement underneath SAS 145 that says you specifically have to stand back and look at your risk assessment and make sure that you did completely identify the accounts, class of transactions, and disclosures that merit having an audit response. I have completely identified the things that have one or more relevant assertions meriting an audit program step. The provision is to make sure that we have thought about the completeness of my risk assessment and, I would say, the continued propriety of not only just that there is a relevant assertion, but where did I place it on the inherent risk scale.

**Ms. Grove Casey**

How should the audit documentation change after this new standard?

**Ms. Louis**

Well, the documentation, ultimately, should make sure that [you fully] put your thought process and your rationale for significant judgments that you are making, to enable somebody who is experienced (like myself) but has no previous experience, though, with your particular client, to understand the nature, timing, and extent of your planned procedures, and why it is that that should lead you to having sufficient and appropriate evidence. Make sure that judgment calls that are significant about your risk and how that links to your planned procedures are also fully documented in that regard.

**Ms. Grove Casey**

Finally, what changed as it relates to responsibilities with information technology (IT) controls?

**Ms. Louis**

They just reemphasized the importance of it, particularly as many organizations are using technology in their accounting and financial reporting systems. And how we need to think about general computer controls and application controls as we are thinking about what is relevant for us to understand in order to do a better job with those risk assessments. You always have had that responsibility of thinking about those areas, they just emphasized the importance of it by adding in some appendices and other guidance that helps you in doing a better job at considering those controls over the IT processes in order to be able to have a better-quality audit. Think about where there is higher susceptibility of risk because of how these systems are set up and implemented and designed to function.



## SUPPLEMENTAL MATERIALS

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### Biggest Roadblocks of Transitioning to SAS No. 145

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by Jennifer F. Louis, CPA

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#### Overview

Revised risk assessment guidance will require auditors to apply new concepts starting with calendar-year 2023 audits. The concept of inherent risk will remain a critical piece of the risk assessment process, and Statement on Auditing Standards (SAS) No. 145, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, has brought a number of changes to enhance clarity and audit effectiveness.

Risk assessment continues to be the foundation upon which an efficient and effective audit is built. Identified risks are the basis for further audit procedures, and the process of identifying those risks is critical. SAS No. 145 enhances the requirements and guidance on identifying and assessing the risks of material misstatement, particularly in the areas of understanding the entity's system of internal control and assessing control risk.

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

SAS No. 145 supersedes SAS No. 122, *Clarification and Recodification*, section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, and amends various AU-C sections in AICPA Professional Standards.

SAS No. 145 was developed using ISA 315, *Identifying and Assessing the Risks of Material Misstatement*.

SAS No. 145 is effective for audits of financial statements for periods ending on or after December 15, 2023.

#### Inherent Risk Essentials

SAS No. 145 introduces the term *inherent risk factors* and adds new requirements to consider those factors, to help in the risk assessment process. Inherent risk factors are intended to steer the auditor toward the factors that affect an assertion's susceptibility to misstatement, resulting in a more focused identification of risks of material misstatement.

Inherent risks represent a key input to the calculation of the risk of material misstatement and are described as "the susceptibility of an assertion about a class of transactions, account balance, or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls."

There are several key points to understand.

- First, inherent risk is related to a management assertion, and management's assertion relates to a class of transaction, account balance, or a disclosure that appears in the financial statements.
- Second, inherent risk is the likelihood that the assertion could be materially misstated on its own or could combine with other misstatements to be material.
- Third, the concept that inherent risk is to be assessed before the consideration of any related control is important.

When making a determination that an assertion is susceptible to a misstatement that individually or in combination could be material, be careful that the assessment truly considers the inherent risk on its own. Reviews performed on audit procedures note that many times auditors base their inherent risk assessment on incorrect conclusions. For

example, an assertion that is easy to audit (such as “cash exists”) does not necessarily have a low risk. In essence, inherent risk comes from the nature of the transaction. The fact that cash is an asset easily misappropriated could contribute to it having higher inherent risk.

Cash that is maintained in a payroll imprest account may have less inherent risk of material misstatement than an operating account due to the nature of the accounts. More persuasive audit evidence may need to be obtained for the operating account compared to the payroll imprest account. The planned nature, timing, and extent of audit procedures may appropriately vary for each cash account based on the inherent risk assessment alone.

### **Tools for Assessing Inherent Risk**

SAS No. 145 defines a new term, *inherent risk factors*, as “characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls.”

Auditors already should be familiar with the term *fraud risk factors*, as those risk factors are discussed in AU-C Section 240, *Consideration of Fraud in a Financial Statement Audit*. Those include considerations such as incentives and pressures, opportunities, and attitudes and rationalizations. Consideration of the degree to which the inherent risk factors affect susceptibility to misstatement assists in the assessment of inherent risk.

Inherent risk factors may be qualitative (“complexity, subjectivity, change, uncertainty, or susceptibility to misstatement due to management bias”) or quantitative (the amount of the class of transactions or account balance can be a factor or “the volume or a lack of uniformity in the composition of the items to be processed”), and may include the more familiar fraud risk factors to the extent that they affect inherent risk.

### **Focus on Qualitative Inherent Risk Factors**

Increased complexity as a risk factor involves the type of information or its preparation. For example, the auditor may see increased complexity in derivatives, warranty reserves, or other areas where the concept is more complex or where difficult estimates occur.

Increased subjectivity is often also seen in estimates or in areas that are judgment based. This risk factor “arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take and about the resulting information to include in the financial statements.”

Change “results from events or conditions that, over time, affect the entity’s business or the economic, accounting, regulatory, industry, or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information.” These events may include disruptions like the COVID-19 pandemic, heightened inflation, or the potential onset of a recession, but could also include things like new technology, new accounting or regulatory requirements (sustainability reporting), or even the social considerations that impact revenue, such as reduced cigarette usage in the face of vaping.

“Susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information,” for example, executive compensation frequently is tied to revenue or profit results, which can result in pressure to misstate the financial statements.

### **Assertion Level Risk**

Under SAS No. 145 inherent risk factors must be considered in assessing risks of material misstatement at the assertion level. Paragraph .35 requires the auditor to “take into account how, and the degree to which inherent risk factors affect the susceptibility of relevant assertions to misstatement.”

Before SAS No. 145, auditors looked at relevant assertions as they related to *material* classes of transactions, account balances, and disclosures. Relevant assertions were those that had a *meaningful bearing* on whether an account was fairly stated. The new relevant assertion definition is clearer. Assertions are considered in light of:

- Likelihood of misstatement
- Magnitude of misstatement

In SAS No. 145, a relevant assertion is defined as:

“An assertion about a class of transactions, account balance, or disclosure is relevant when it has an identified risk of material misstatement. A risk of material misstatement exists when

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

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

A relevant assertion is an identified risk of material misstatement when a *reasonable possibility* of its occurrence is present. Reasonable possibility means a more than remote chance of happening. If it happens, a material misstatement must be possible. There is an emphasis upon probability and dollar impact and, again, internal controls are ignored in making this determination. That is, inherent risk is the basis for determining which assertions are relevant.

An example of a low inherent risk is the existence assertion for payables. If experienced payables personnel accrue payables, then the existence assertion might be assessed at low because the directional risk of payables is an understatement, not an overstatement. The lower risk assessment for existence allows the auditor to perform few, if any, procedures in relation to this assertion.

Conversely, the completeness assertion for accounts payable commonly is a high inherent risk. Businesses can inflate their profits by accruing fewer payables. Fraudulent reporting of period-end payables is possible. Therefore, the risk of completeness for payables is often higher. That is why auditors perform a search for unrecorded liabilities and other procedures to try and detect the understatement of liabilities and related expenses.

Inherent risk factors are a required topic to discuss when the engagement team gathers to hold discussions about the application of the applicable financial reporting framework, and the susceptibility of the entity’s financial statements to material misstatement.

If inherent risk is legitimately low, the auditor can perform less substantive work; however, if the assertion is high risk, then it should be assessed accordingly—even if that means more work.

### **Significant Classes or Transactions, Account Balances, and Disclosures**

In SAS No. 145, significant classes of transactions, account balances, or disclosures are defined in the following manner:

“Significant class of transactions, account balance, or disclosure. A class of transactions, account balance, or disclosure for which there is one or more relevant assertions.”

A significant class is one with a relevant assertion—one where the likelihood of material misstatement is more than remote. Thus, if an account balance like receivables, for example, has a relevant assertion, it is a significant account.

The purpose of this definition is to provide clarification concerning the scope of the auditor’s work. In other words, this definition tells the auditor where to focus. The auditor will perform risk assessment procedures and assess risk in the significant classes of transactions, account balances, and disclosures. It is in these areas where the auditor will

plan responses to the identified risks therein. SAS No. 145 requires substantive procedures for each significant class of transactions, account balances, and disclosures with relevant assertions.

Consider this hypothetical example: Suppose plant, property, and equipment (PP&E) is material. Yet, if there is no relevant assertion for the account balance, it is not a significant area. Assume a company has \$10 million in PP&E (a material balance that has been audited in prior years), but it purchases no new capital assets during the year. There is only one PP&E asset in the current year, a building, which has appreciated. Is there a relevant assertion? Probably not. Why? There is little likelihood of material misstatement in any of the assertions. If we change the scenario and the building suffers an earthquake, is PP&E a significant class? Yes, if substantial damage occurred and we now have a relevant assertion: valuation. Yet, in our required stand-back assessment we may decide to audit any area, despite whether there is a relevant assertion, because we believe our planned audit is incomplete without it.

### **Significant Risk Revised: Definition Changes**

Understanding the changes to significant risk is critical when undertaking audits under SAS No. 145. Remember, proper risk assessment forms the foundation of an audit.

Understanding which risks qualify as “significant” is important, in part because auditors should enhance their responses to those risks. Under SAS No. 145 auditors are required to identify controls that address significant risks, and to evaluate whether the controls have been designed effectively and implemented. Additionally, AU-C Section 330, *Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained*, includes special audit considerations in the form of specific requirements related to significant risks because of the nature of the risk and the likelihood and potential magnitude of misstatement related to the risk.

Paragraph .12 of SAS No. 145 defines “significant risk” as “an identified risk of material misstatement for which the assessment of inherent risk is close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur, or that is to be treated as a significant risk in accordance with the requirements of other AU-C sections.”

While in the past auditors thought of a significant risk as one that required special audit consideration, i.e., the auditor’s planned response to a risk is what determined whether it was considered significant. This resulted in diversity in practice. The AICPA Auditing Standards Board (ASB) noted the behavior as “a lack of consistency with which significant risks are determined,” in its inspection findings. The ASB believed “one of the main reasons for this inconsistency lies in the definition of significant risk” and hopes that the revised definition will address this issue.

Going forward, the auditor’s assessment of inherent risk will determine if a risk of material misstatement qualifies as a significant risk. Significant risks may still require special consideration--the auditor still must respond appropriately and apply the guidance of AU-C Section 330.

The revised definition also considers where the risk falls on the “spectrum of inherent risk.” To identify significant risks under SAS No. 145, the auditor needs to understand the spectrum. For example, a bank’s allowance for loan losses usually is a significant risk because it is a complex estimate in a material account balance. It is likely to be at the higher end of a spectrum of inherent risk.

### **Spectrum of Inherent Risk**

The “spectrum of inherent risk” is a new concept in SAS No. 145. In application, auditors consider the inventory of inherent risk factors identified, such as complexity, subjectivity, or uncertainty, from all risk assessment processes performed, including the auditor’s required understanding of the entity. Inherent risk factors represent characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, *before consideration of controls*.

Based on their understanding of inherent risk factors, auditors can assess the likelihood (“the possibility that a misstatement may occur”) and magnitude of a misstatement (“the qualitative and quantitative aspects of the possible

misstatement”). Ultimately, it’s the intersection of the magnitude and likelihood of the material misstatement on the spectrum of inherent risk that determines risk levels, including whether a risk should be deemed significant.

### **Guidance on Scalability**

In actual practice, some firms use a low/medium/high scale, while others may use a numeric scale. The auditor can simply use a ten-point scale, with a ten being the highest risk. This feature of a firm’s methodology remains applicable because the spectrum of inherent risk is, itself, a scale. How an inherent risk potentially affects misstatement indicates where that risk belongs on the spectrum.

Under SAS No. 145, a risk is a significant risk if the inherent risk is, per the definition provided, “close to the upper end of the spectrum of inherent risk due to the degree to which inherent risk factors affect the combination of the likelihood of a misstatement occurring and the magnitude of the potential misstatement should that misstatement occur.”

By focusing attention on auditing those areas with higher risks of being materially misstated, which includes those identified significant risks, auditors create a scenario to perform an effective and efficient audit.

### **Are Certain Risks Always Significant?**

When applicable, significant risks include those that should be treated as a significant risk in accordance with the requirements of other AU-C sections.

Although determining which assessed risks are significant risks involves professional judgment, guidance in other AU-C sections, for example, AU-C Section 240, provides additional requirements in relation to the identification and assessment of the risks of material misstatement due to fraud, and AU-C Section 550 does the same with respect to related-party transactions.

### **Are Smaller Entities Lower Risk?**

Complexity of an entity’s activities and its environment, including its system of internal control, is the primary driver of scalability. SAS No. 145 recognizes that although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex.

Size and complexity do not necessarily correlate. Smaller entities tend to be less complex, but some are not. Larger entities tend to be more complicated, but some are not. Consider the accounting system, the industry, the internal controls including information technology, and other factors in applying SAS No. 145. Complexity, not the entity’s size, determines how to use this standard.

### **Enhanced Auditor Responsibilities—Understanding the Entity and Its Environment**

SAS No. 145 requires inherent risk factors to be considered during audit procedures to understand the entity and its environment, and the applicable financial reporting framework. Paragraph .19 requires that auditors “obtain an understanding of ... how inherent risk factors affect the susceptibility of assertions to misstatement and the degree to which they do so, in the preparation of the financial statements.” These procedures are based on the results of the auditor’s gathered understanding of the entity and its environment.

### **Revised Requirements—Evaluating the Design of Certain Controls**

SAS No. 145 clarifies that the overall understanding of the entity’s system of internal control is achieved through understanding and evaluating certain aspects of each of the following components of the system of internal control:

- The control environment
- The entity’s risk assessment process

- The entity's process to monitor the system of internal control
- The information system and communication
- Control activities

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

The use of the term controls has been clarified and defined as "Policies or procedures that an entity establishes to achieve the control objectives of management or those charged with governance."

### **Separate Assessment of Inherent and Control Risk**

For risks of material misstatement at the assertion level, SAS No. 145 now requires separate assessments of inherent risk and control risk, which is consistent with SAS No. 143 on auditing estimates.

Auditors are explicitly required to assess control risk at the maximum level such that, if the auditor does not plan to test the operating effectiveness of controls, the assessment of the risk of material misstatement is the same as the assessment of inherent risk. Therefore, if the inherent risk is assessed higher than it should be, the auditor may waste time performing unnecessary work to address the risk.

Many auditors assess control risk at high or maximum, regardless of the internal control structure—whether the controls are designed appropriately and implemented or not. Frequently auditors plan to use a fully substantive approach; for example, when testing controls for effectiveness is more time consuming than just using substantive procedures. When the auditor testing the operating effectiveness of identified controls is not part of the plan, evaluation of the design and determination of the implementation of controls still may assist in the design of substantive procedures.

The evaluation of the design and implementation of controls (i.e., walkthroughs) still can impact the planned audit procedures, even if control risk is assessed at maximum. Increased risk leads to a change in the nature, timing, and extent of planned audit procedures. For example, if the walkthrough reveals a lack of segregation of duties, the auditor may need to add more substantive procedures to address fraud risk.

When identified controls are designed effectively and implemented, risk assessment procedures may influence the auditor's determination of the nature and timing of substantive procedures to be performed (for example, the auditor may determine to perform inspection, rather than external confirmation, or to perform procedures at an interim date, rather than at period end).

### **Focus on Maintaining Professional Skepticism**

The new standard clarifies that an appropriate understanding of the entity and its environment, and the applicable financial reporting framework, assists in maintaining an attitude of professional skepticism throughout the audit.

One of the benefits of the engagement team discussion is the ability to have a robust and open dialogue about where there is the greatest potential for material misstatement in the financial statements due to either fraud or error.

In addition, the new standard highlights that contradictory evidence may be obtained as part of the auditor's risk assessment procedures. Any inconsistencies in audit evidence, obtained at any point in the audit process, should be resolved if material misstatement due to fraud or error could result.

Professional skepticism is necessary for evaluating audit information in an unbiased manner, leading to better identification and assessment of risks of material misstatement.

## “Stand-Back” Requirement

This stand-back requirement is intended to drive an evaluation of the completeness of the auditor’s identification of significant classes of transactions, account balances, and disclosures.

Once auditors have designated all significant classes of transactions, account balances, and disclosures, all remaining material areas should be evaluated to determine if initial scoping was appropriate.

The purpose of the stand-back provision is to ensure completeness of the auditor’s identification of transactions, account balances, and disclosures—the areas the auditor plans to audit.

## Focus on Audit Documentation

SAS No. 145 revises the audit documentation needed to include the following new requirements:

- Documentation of the evaluation of the design of identified controls and determination of whether such controls have been implemented;
- The rationale for significant judgments made regarding the identified and assessed risks of material misstatement; and
- Sufficient documentation to enable an experienced auditor with no previous experience with the audit to understand the nature, timing, and extent of the risk assessment procedures performed and the results of those procedures.

## Focus on Information Technology (IT)

SAS No. 145 emphasizes IT controls as they affect the risk of material misstatement. The standard introduces a new term: “risk arising from the use of IT,” and it defines general IT controls.

While no particular framework is required, the COSO 2013 *Internal Control—Integrated Framework* is referenced. Auditors will be placing increased emphasis on the IT environment as part of the external audit process.

For example, if occurrence is a relevant assertion for expenses, the auditor might consider an IT control that requires a three-way match for invoice processing: the software will not allow a disbursement without matching the invoice amount, the purchase order amount, and the quantity in the receiving document. In such a system, the IT application is the payables module in the software.

An example of a general control for this application is the password for access to the payables module. Why is the general IT control (the password) important? If a password was not necessary, then anyone could process payments, and this affects the occurrence assertion.

As auditors perform a walkthrough for payables, they will (for example):

1. Inspect the three-way match documents
2. Observe the payables module in use
3. Inspect the logical access records from IT, showing who has access to the payables module
4. Observe the entry of a password by a payables clerk

SAS No. 145 defines general IT controls as “[c]ontrols over the entity’s IT processes that support the continued proper operation of the IT environment, including the continued effective functioning of information-processing controls and the integrity of information in the entity’s information system.” Examples of general IT controls include firewalls, backup and restoration, intrusion detection, passwords, physical security, and antivirus protection. The auditor does not need to review all general controls, only those related to risks arising from the use of IT.

SAS No. 145 defines risk arising from the use of IT as the “[s]usceptibility of information-processing controls to ineffective design or operation, or risks to the integrity of information in the entity’s information system, due to ineffective design or operation of controls in the entity’s IT processes.”

Entities are less likely to be subject to *risks arising from the use of IT* when they:

- Use stand-alone applications
- Have low volumes of transactions
- Have transactions supported by hard-copy documents

Detailed testing of IT controls may be required depending on organization’s size and complexity.



## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Discuss some factors that you believe would cause an account, class of transaction, or disclosure to have a significant risk at the higher end of the inherent risk spectrum.
2. Discuss the auditor's consideration of an entity's size when performing risk assessment under SAS No. 145.
3. Discuss the "risk arising from the use of IT" as it is used in SAS No. 145.

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**B. Suggested Answers to Discussion Problems**

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1. Increased complexity as a risk factor involves the type of information or its preparation. For example, the auditor may see increased complexity in derivatives, warranty reserves, or other areas where the concept is more complex or where difficult estimates occur.

Increased subjectivity is often also seen in estimates or in areas that are judgment based. This risk factor “arises from inherent limitations in the ability to prepare required information in an objective manner, due to limitations in the availability of knowledge or information, such that management may need to make an election or subjective judgment about the appropriate approach to take and about the resulting information to include in the financial statements.”

Change “results from events or conditions that, over time, affect the entity’s business or the economic, accounting, regulatory, industry, or other aspects of the environment in which it operates, when the effects of those events or conditions are reflected in the required information.” These events may include disruptions like the COVID-19 pandemic, heightened inflation, or the potential onset of a recession.

Uncertainty comes “when the required information cannot be prepared based only on sufficiently precise and comprehensive data that is verifiable through direct observation.” Uncertainty might be found in estimates of potential legal action against an entity. The likelihood of a negative judgment may be high, but the amount of monetary loss may be uncertain.

“Susceptibility to management bias results from conditions that create susceptibility to intentional or unintentional failure by management to maintain neutrality in preparing the information,” for instance pressure to achieve a desired result that could lead to a misstatement in the financial statements which, if intentional, may result in fraud.

2. Complexity of an entity’s activities and its environment, including its system of internal control, is the primary driver of scalability. SAS No. 145 recognizes that although the size of an entity may be an indicator of its complexity, some smaller entities may be complex, and some larger entities may be less complex.

Size and complexity do not necessarily correlate. Smaller entities tend to be less complex, but some are not. Larger entities tend to be more complicated, but some are not. Consider the accounting system, the industry, the internal controls including information technology, and other factors in applying SAS No. 145. Complexity, not the entity’s size, determines how to use this standard.

3. SAS No. 145 defines risk arising from the use of IT as the “[s]usceptibility of information-processing controls to ineffective design or operation, or risks to the integrity of information in the entity’s information system, due to ineffective design or operation of controls in the entity’s IT processes.”

Entities are less likely to be subject to *risks arising from the use of IT* when they:

- Use stand-alone applications
- Have low volumes of transactions
- Have transactions supported by hard-copy documents

## PART 3. SMALL BUSINESS

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### Comfort Letters

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We considered comfort letters as part of our nonaudit attestation options last month. This month we'll take a closer look at these engagements and what professionals can offer to clients.

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

#### Ms. Grove Casey

So today we want to talk about something that many third parties really like to use, and that's comfort letters. So to begin with, let's talk about what a comfort letter is.

#### Mr. Oestrieher

Do you want me to use colloquial terms or do you want me to use some of the names that I've used far enough? I guess in general terms, a comfort letter is a way to provide some type of assurance or some level of assurance to a third party that information being conveyed to that third party is accurate. That's the best way I can say it. We actually had that term in audit standards for years for comfort letters. My first introduction to a comfort letter was back when long before we had the PCAOB had a client that needed an extra \$85 to 100 million of capital and you don't exactly run down to your local bank and do that. So they did a public bond offering which means that the underwriters they said right before pricing there's lots of information being provided and in those days we didn't have the technology we had now we're literally we're handwriting on the document A and then putting a note, hey this is accurate. So that we have to perform procedures that said, yes, we have evidence of some sort or some sort of guidance that says, yes, this is accurate. So that's the highest form of a comfort level letter when the third party expects the CPA to follow a certain set of standards, whether it be in the auditing standards or the attestation standards. Those don't cause CPA firms problems because everyone understands there's a cost involved and there's a process involved. What we want to focus on here today is the third-party lenders and some of these other people that say, hey, just get your CPA to verify your income or your CPA to verify the amount of debt. And the client expects us to write a letter and not even bill them for it and use the format that that lender or third party wants. And so that's what we're going to discuss is how to handle that. I mean, there are ways that we can do that, but it's expensive for the client and it takes time. So we're going to talk about what we can do, what we can't do, and some things you can do, but maybe you shouldn't want to do it because of the risk. And then what standards you would follow and how to address the situation with all involved. So that's the type of comfort letter we're talking about today, not the one that we think of as the more formal comfort letter that everyone expects us to follow standards.

#### Ms. Grove Casey

So are there specific types of information that usually is involved related to those comfort letters?

#### Mr. Oestrieher

I think the most common one that I see is verification of income and verification of self-employment. We also get some that say we want to verify the amount of debt. The strangest ones are the ones that came up a few years ago where people said, oh, we want you to write a letter saying that once there's a cash outflow for like a down payment on something or if there's a distribution to pay taxes, that the company has sufficient capital to survive. And the first time I saw one of those, I said, what do they expect, we have a Ouija board? I mean, under no circumstances could a CPA ever write a comfort letter or communicate in any way, shape or form that something could happen in the future or that there's a cause and effect of current events on future events. So just, when you get one of those, just, hey, there's no way we can do that. You just have to talk to the client up front and say, we can't do it. And I guess what I'm about to tell you applies to all of these. Then the client goes to the lender and then says, well, my CPA said they can't do it. The lender always says, well, we get all these all the time from CPAs. So the client comes back mad at us. And I said, well, A, they either got it from H & R Block or somebody that's not a CPA. Or B, they got it from a CPA that doesn't understand the standards and we can't help it if other people violate the standards. So you can't have to work that relationship. But, it's the things that are historical such as income. Those are things we can write letters on

and we can say things like a W-2 was issued to this individual in this amount and we included it on their 2022 tax return. So that's a factual statement. But what's interesting about that is we're not giving that lending agency any more information than they already had because they have a copy of that W-2 also. And I'm not going to verify the accuracy of the W-2, because as far as I know, that client could have gone and printed one. There's all sorts of software out there. So now if someone wants us to do research and confirm with their employer that that amount was paid, then, you know, now we're in the realm of something we can do. So it is the wording of these things. It's not only the type of content and the type of information, it's the type of assurance that the third party wants. That's where we have to be very, very careful. and make sure that we are providing something that can be provided, and then, applying the appropriate standards and using the appropriate language. That's the puzzle that we're going to talk through today.

**Ms. Grove Casey**

So let's talk a little bit about the professional considerations, because you mentioned the historical information a moment ago, and there are certain things that we can communicate, but there are also things that we need to consider when we're doing that.

**Mr. Oestriecher**

Right. I think the first thing we want to think about is client confidentiality. If you are contacted directly by a third party to provide some of this information, such as let's just say a tax return, remember you have to get the client's permission. Now, often the client will drop off or send an email. If the client sends me an email that says, hey, can you please provide the tax return to this third party? To me, that's written permission and interestingly enough, there is no where in the standards that says the permission from the client must be in writing. I'm telling you; you want to get it in writing. In emails, I literally just print that PDF of the email from the client, put it in the file. You know, I have people file their electronic files in all different manners, but for us, it'd be the, you know, the 2022 or 2023 file, you know, communication to bank, whatever. And I just print that email in there. So, so that's the first thing. If you have a direct request from somebody, you have to get the client involved. Make sure you get permission. And then always make sure that the information that they want is both historical and factual. What do I mean by historical? It is something that has happened. I didn't just give you the example of wages. It could be a level of debt incurred. Whatever it is, it has to be historical. It has to be factual. It can't be your opinion. You can't say, oh, they had a good year last year. All depends on what your definition of a good year is. Anyone that's followed this series know that I'm a football fan. And so for LSU football team, anything less than beating Alabama and getting at least 10 wins is not a good year. But my alma mater, ULM, if we get to a bowl game, that's a good year. It's all in the perspective of what you are looking at when you determine. So make sure you have those parameters. And then once you have the client's permission and the information is factual and historical, now you can start making the decision of, okay, what can I say? What can I not say? What standards should be applied? But those are the first two hurdles that I think we need to look at whenever we're dealing with these types of comfort.

**Ms. Grove Casey**

Let's talk about what kind of standards we would be doing these engagements under.

**Mr. Oestriecher**

There are, first of all, always anything that a CPA is involved in, you have to look at the Code of Professional Conduct. And mainly we're looking at confidentiality there, but you also have other rules. And again, mostly I'm talking about CPAs in public practice here. So you look at Section 1 and you have general information. You have to follow the standards. That's in Section 1.300. So make sure you're aware of any responsibilities you have under AICPA Code of Professional Conduct. in certain circumstances, you could even potentially have a conflict of interest. May be rare, but you might want to consider those depending on the magnitude of what you're doing. So once you get past the code of professional conduct and understand that there are no ethical barriers, and I think that would be the case on most of these types of engagements, there won't be any ethical barriers, independence could be an issue, of course. Then you say, okay, how do we want to handle this? In most cases, I think you're going to want to look at the attestation standards. And that's where you have different, there's a new, you have the assertion-based exam, a direct examination, a review and agreed upon procedures. And under the assertion based and direct examination, that's where you're providing reasonable assurance. In other words, of the same type of level of assurance, I should say,

that we provide in an audit. So automatically our brain should say, that's going to be a lot of work. and it's going to be a large fee. There will be engagement letters involved. There will be representation letters involved. And if anyone's never read the, or has ever read the attestation standards, instead of talking about financial statements like we do in an audit or review or compilation, these are designed to have the CPA provide assurance/comfort on anything. So they use terms like subject matter and criteria. That gets back to what I was talking about, historical information and factual. In other words, there has to be specific criteria applied. An example, if someone wants a level of comfort that an individual has been employed for the previous 24 months consistently with the same company, okay? That's my criteria employment, okay? So I have that. What is the subject matter--the length of time and the criteria. So now I know that I have something that... is factual in nature and it is appropriate. That's one of the things we have to determine, if it is appropriate. And once we define those items, then again, we could spend two hours talking about what exactly you'd have to do in an assertion-based or direct examination, but you would go get the work and obtain evidence to support whatever that assertion that is being made and that criteria that is embodied with what needs to be communicated. And I know that sounded very confusing, but that's how they have to write the standards because they want to be able to expand this to anything, whether it be employment, wages, compliance, whatever it might be. But it gets back to what I said earlier. It's not a suitable criteria if they said, oh, they've had a couple of really good years. Again, that's their criteria. It's good, but that's too subjective. So understand that that is the way the attestation standards are written. Now, if the client or the third party does not need reasonable assurance or the client does not want to pay for reasonable assurance, then you can get to a review, which is limited assurance. The same thing that we have in the financial statements. Again, but this is a review under attestation standards. You still have to have the same benchmarks, if you will, for criteria and subject matter. That doesn't change. It has to be something that I can obtain limited assurance on. So again, it has to be something very specific. I have to understand what is the criteria. In other words, what are the measurables? And then I just apply limited procedures. Then I can issue a review report under the attestation standards. And I want to make sure you understand this, as I go through this, the client never wants to pay for it. And the third party goes, oh, we don't need that. And I say, okay, well then. What do you need? Just write a letter saying that you verify their income. Well, you see, I can't do that because you're using the word verify. So this is typically the part of the conversation and understand this is why Zoom calls and things like that. I don't know if I should use a brand, but group meetings via the web is maybe that's a better generic way to say it. You just get all people in the same room because instead of one going back to the other and there's a miscommunication, you just get all three parties together and say, Why do you need this? What do you need? Here's what we can do. I have literally pulled up standards and there's some great AICPA guidance on the AICPA website that helps us communicate this information. It's just, this is how you tell them. And so I can show them on the screen. And I have educated a lot of third parties, that they go, wow, we've been getting all this stuff and we didn't realize that we shouldn't have been asking for it. And then I know that they're being nice and they're going to continue to ask for it as soon as they get. Well, maybe the next CPA won't be as informed as the idiot in Louisiana and we'll get someone. Because remember, ultimately, they just want this information in the file when their regulators come. That's the whack-a-mole game we're playing here. But if the third party, and remember, the client always says, I just want the information as cheaply as possible. Whatever I can do to write the smallest check possible, that's the client's position. So it's really a negotiation with that third party. Sometimes you can do agreed upon procedures, and then... but now you're not giving any kind of an opinion or assurance. You're just simply saying, you wanted to know if they filed tax returns. So, the agreed upon procedure is, we did the necessary forms with IRS to verify that tax returns were filed, which again, the lending agencies are doing anyway. But if you have electronically filed them, then you can say, okay, we went to our software and we printed out and we verified or we received communication from the IRS that the return was accepted on a certain date. Because remember, on agreed upon procedures, you're just reporting those findings. And in some cases, I have been able to satisfy lenders with that, and it's very easy. If it's our client, that doesn't take a lot of time. But remember, you still have an engagement letter, you still have a report, it's going to be a two to three hour engagement. And depending on what your billing rates are, as we know, I'm not doing anything very cheap I can assure you, so the clients are always a little bit upset. And I'm probably branching a little bit off here, but one of the things that gets me is these, our clients, everybody's clients, they go do these refinancings. Have you ever seen the HUD form on a refinancing? There are all these fees to everybody. They're getting \$100 to go run to the courthouse and file things. So you have all these fees. It's just, okay, our \$600 fee, just that's one of the costs of doing this, like all the attorneys and everything else. It's just amazing to me that we seem to be the linchpin on this. Everyone wants us to write a letter, but everyone expects ours to be free, but they're going to pay somebody

else. I love those \$150 courier fees. So it is just a matter of educating the client and I've always said, we just need to be paid out of closing, and it's just part of the overall closing cost and then the bank sent us a check and then I think everyone would be happy, but understand the attestation standards are where you're going to want to go to report on anything that would fit into what I would call this type of comfort letter that we're discussing when they want you to use words like verify and things like that.

**Ms. Grove Casey**

Are there certain things that we should avoid?

**Mr. Oestrieher**

Yes. I've kind of touched on that as we discussed this, but what you really need to ask yourself is what level of assurance is the third party asking for? And did I perform the procedures necessary that would be reasonable? Because remember, they always want this from a CPA. Why? Because people trust CPAs. The CPA won't lie. I recently had a situation where a university is a great concept. It's an alumni group for a university and they want to recognize the fastest growing businesses that are run or owned by alumni of that particular university. And I think that's a great concept to get people involved and get donations going. But one of the things that they required, you can't just submit your revenues for the last three years. They want a verification letter from your CPA. So, of course, my client gave me this and I said, I can't write this letter. They said they do it all the same, all the discussion we just had, except instead of a lender, it's an alumni association. And ultimately, when I got the alumni association involved and they realized, oh yeah, well, I guess you would want to charge for that. So I've talked to them about alternatives, about using the tax return or something else to measure. Of course, then you bring in cash versus. or your GAAP versus tax basis. And trust me, when we finished that discussion, that alumni group was like, damn, should we even do this? It seemed so easy. What's your revenue growth? But how do you measure your revenues and how do you verify the numbers? That was the problem that they had. So sometimes I'm a frustrating person to deal with because I tend to sometimes bring more problems than what people anticipated, but at the end of the day, we had a very, very good conversation on that. So. watch those types of things when you're asked to verify something. Again, we can, but run to the attestation standards. I think the other thing you need to avoid again, the subjective terms, and also avoid anything that has to do with predicting the future. Does the company have cash flow to provide for operations for the next 12 months? I think I've seen that. Well, as we all know, you can look at a forecasted budget or something like that. But I don't know, could something like COVID-19 hit? You know, I would not have liked to have been a CPA that in early 2020 wrote a letter to somebody saying, oh, based on these cash flow projections, there is little to no chance of bankruptcy. I would not have wanted to have written in the first place, but you don't want to do that.

**Ms. Grove Casey**

Well, we're not at the stage of the title people yet, where they have to have insurance. After you pay them to do their job, you have to pay for insurance, that they did their job correctly. So let's talk about cash flows though, because you mentioned that a moment ago.

**Mr. Oestrieher**

Yes, and that's where I think we can get into some of the less expensive options for people. If they truly want to understand if the third-party lender, and I think this is a very reasonable request, they want to understand are there any surprises in the future? So what can we do about cash flow modeling for the future? And this is something we do all the time. Heck, I do it for my CPA firm. I just don't have to present it to anybody. And that's where you can use the compilation or the preparation standards. A lot of people think of those standards as only for historical financial statements, but the Committee, the Accounting and Review Services Committee, that writes the SSARS, did a great job a few years ago of opening up or changing the definition of the applicability of both a preparation or a compilation engagement to allow not only historical financial information, but forecasted or projected financial information. Notice how we call it financial information instead of a financial statement. We always use the term statement to refer to historical data and information to refer to projected or pro forma. And I highly recommend using the compilation option because then there is a report attached. Remember the whole purpose of a preparation engagement is that you don't attach a report. Well, if I'm issuing this, I want the report because the report has the necessary disclaimers in it that let people understand we didn't audit it. We didn't review it. There's no assurance. And most importantly, that we had no obligation to update it should facts or circumstances change. And remember, anytime

you're showing forecasted or projected information, you have to show your summary of significant assumptions, not accounting policies, but assumptions. What is your growth rate? Any changes like if debt is expected to be refinanced? So any assumptions that you used would be included. A great example, when we do this, we have a lot of nonprofit schools as clients. So of course, what do they want to know? All right, what does our cash flow for the next year look like if the tuition rate is at level A? If we keep it the same, 2% increase, 5% increase, we can do that. That is extraordinarily valuable information to the boards when they are determining what tuition should be, but what are the assumptions? How many students do we have? What is the increase in teacher salaries? What are any other increased costs? That's how they provide the information. So I think that is a great example of when we're, it still kind of comes into comfort because they want a CPA doing these projections, maybe not just necessarily the administration, who are wonderful people that understand education curriculums, understand the needs of students, but maybe they don't understand the financial side of it the way a CPA would. That's why they want to get us involved. And when I present at these meetings, I said, now, when we come next year and show you the historical, according to these projections, you're going to have a cash balance. I'm just making up a number. This is no client. You'll have a cash balance at the end of the school year of \$314,732. That's what you're going to see on this. When all's said and done, that ain't gonna be the number. It's going to be more or less depending on, you get two more students. But we stress that, but it gives them an idea. I think that's just a great example of where we can have a fairly low cost standard that provides very valuable information for decision making, yet also there's an understanding that we're not providing any assurance that that is what will actually happen. So I love the compilation engagement when it comes to forecasted cash flow information and now we're talking about specific assumptions. Again, I've talked about something needs to be historical or it can be factual assumptions where I can do math and say, yes, I have this many students at this tuition rate, I should say, then I can apply the math. The math that results from those assumptions is what is factual, and then we can report. Only on a compilation, though. Remember, preparation doesn't have a report. You are not allowed to do a review or an audit of projected financial statements because we cannot provide assurance. That's where the assurance on future events, you just simply can't do that. And if that is something that the third party doesn't accept, then you just go on to your next client and do something else, but don't do what they're asking for.

**Ms. Grove Casey**

So, let's wrap up on what are your final thoughts related to comfort letters?

**Mr. Oestricher**

It goes back to a slogan I think I heard in the 80s, just say no. And I think that is the best way to handle many of these requests. And the lending company will in fact go through with the loan. They're trying to get it, they want one other person to sue if the loan fails or to make the regulator happy. But in most cases, the client can get what they need from the third party without these types of comfort letters. So start out by saying, no, I can't do that within my standards. See where it goes from there and then kind of get into some of the discussions that we had. I mentioned the AICPA website. There are some very valuable tools on there. There's actually a technical practice aid that provides a lot of the guidance. So the things that we've discussed today, I wish I could tell you they were my opinion and I'm a brilliant person and I've thought of all these things myself and I've solved the world's problems on comfort letters and world hunger's next. I'd love to be able to tell you that, but that's not the case. The information that I got is from my own experiences, but also from talking to very smart people at the AICPA and other smart practitioners that have followed this. So use those resources at the AICPA website. I think one of the big things is, I like to please people. I don't like to say no. I like to be that CPA that when my client needs something, they can come to me and say, and I'm going to solve their problem for them. And how easy would it be to have me just to write a letter that says, I verify their income was X, even though I only maybe had compilations or only maybe had a tax return. They're honest people. They're nice people. Our kids play baseball together So they wouldn't lie. So it's so easy in five minutes now. Everybody's happy. You didn't charge the client. The client didn't get a bill and now all the problems are solved until the loan goes bad or until something else happens. Remember that you're a CPA and don't fall into that trap of trying to please your clients like most CPAs I know. We like to be problem solvers. So don't fall into that trap, and again, the three-way communication between all parties involved can generally quickly lead to a resolution of exactly what they need and what you can do at a price point that the client is comfortable with and then you proceed from there.

### Comfort Letters—CPA Responsibilities

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by Kurt Oestricher, CPA

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#### Introduction

CPAs are often asked to provide certain representations, verifications, or other assurances about their clients to lenders. Such requests are referred to as comfort letters. While some information can be provided, many times the CPA is prohibited from providing such assurance. This discussion will focus on the common requests, differentiate between allowable and prohibited services, reference standards that can be applied, and provide practical guidance to assist the CPA.

#### Common Requests

The CPA in public practice is often requested to provide the following types of verifications or assurances:

- Confirmation of self-employment status
- Verification of income from self employment
- Verification of a self-employed borrower's ownership percentage
- Profitability or sustainability of self-employed income
- Impact on business if funds are withdrawn to fund downpayments

The key issue to remember in deciding whether to accept the engagement is understanding what type of information or assurance is requested. In most cases, the CPA can provide assurance on information that is verifiable or factual. However, any assurance related to future performance or sustainability cannot be provided by a CPA.

In most cases, the third party that is requesting such information is on a fishing expedition—most of these requests are for lenders and they are simply trying to get someone else on the hook for the loan. The CPA is often put in an uncomfortable situation because you want to please your client, but you understand that the assurance requested cannot be provided. The lender or other third party will often tell your common client that others always provide this information, and that the CPA is obstructing the lending process. A clear understanding of your responsibilities, coupled with a conference call with all relevant parties present, will often provide a solution to the dilemma faced by the CPA.

#### *Confirmation of Self-employment Status*

Because the third party typically is requesting the representation as of a specific date, this is a representation that a CPA will want to avoid. To state that an individual was self employed as of a certain date is very tricky. The CPA would have to rely on the representation of the client that he or she was actively self employed as of a certain date. This is a representation that the lender can request directly from the client. Oftentimes, the lender may ask for a bank statement for the preceding month that would indicate the business activity of the self-employed person instead of requesting the assurance of a CPA.

A representation that a CPA can make would be related to the preparation and electronic filing of an income tax return for the client that reflected self-employment income, because that is a factual action that can be verified. A CPA can also prepare or compile financial statements of a business enterprise that would indicate current self-employment income, and the client may wish to add selected information that would indicate the tax status of the entity. In this case, there is enough information for the third party to draw its own conclusion as to whether or not the client is currently self employed.



### ***Verification of Income from Self Employment***

This type of assurance is very tricky as income is an amount that typically is presented on an income statement. When issuing reports on income statements, the CPA may compile, review, or audit. None of these services provide a report in which the CPA “verifies” the net income. The level of assurance provided would, of course, be dictated by the type of engagement that is agreed to by the CPA and client. In most cases, the client does not want to pay for an audit or review, neither of which would provide the “verification” requested by the third party.

A CPA can provide a copy of a Schedule C that he or she prepared, or a K-1 from a partnership return that was either prepared by the CPA or used by the CPA in the preparation of the client’s income tax return. The CPA can affirmatively state that the Schedule C or K-1 was used in the preparation of the tax return for the client. Then, it is up to the lender to determine if the information provided is sufficient for their purpose.

### ***Verification of a Self-employed Borrower’s Ownership Percentage***

This is another example of using the information on tax filings that would be appropriate. It is important that in any written communication the CPA refer to the tax-year-end date and state that “as of December 31, 2023, I prepared and filed a Schedule C which was included in the income tax return for Jane Doe.” Jane Doe represented that she was the sole owner of XYZ business operations that were reflected in the Schedule C.

The reasoning for pegging the ownership percentage to a certain date is that the CPA may not be aware of any new equity owners that have bought into the enterprise (or sold out of partnerships) since the tax return date. The CPA would have to rely on the same representations of the client that he or she has not divested any ownership percentage, so it is in the best interest of the CPA to have the lender request this representation directly from the client.

### ***Profitability or Sustainability of Self-employed Income***

While this request is becoming more common, a CPA is specifically prohibited from providing any assurance on future events. Some lenders have become very forceful in requesting this assurance from a CPA, but do not let yourself be talked in to providing such information.

### ***Impact on Business if Funds are Withdrawn to Fund Down-Payments***

This request comes in different forms. If a lender requests the CPA to provide a calculation of the impact on working capital, this can be achieved by preparing a balance sheet or obtaining information from the general ledger as of the request date and calculating the impact on working capital by deducting the amount of funds to be withdrawn.

However, if the lender requests a vague representation such as, “Please verify that the company can sustain operations if funds are used for a down payment,” the CPA would be precluded from providing such a representation as it is a prediction of future events.

### ***Appropriate Responses from a CPA***

When determining how to respond to comfort letter requests, the CPA should first determine if the request is appropriate and can be provided under standards. If the requested information is for an assurance that is prohibited (such as future performance), then the required action is to not provide the requested assurance and inform the third party and the client of the reason for the non-response. This is a courtesy; it is not required by standards.

A CPA should also be aware of the AICPA Code of Professional Conduct in responding to third-party requests. The following rule obtained from [aicpa.org](http://aicpa.org) relates to confidential client information:

#### **1.700.001 Confidential Client Information Rule**

.01 A member in public practice shall not disclose any confidential client information without the specific consent of the client.

.02 This rule shall not be construed (1) to relieve a *member* of his or her professional obligations of the “Compliance With Standards Rule” [1.310.001] or the “Accounting Principles Rule” [1.320.001], (2) to affect in any way the *member’s* obligation to comply with a validly issued and enforceable subpoena or summons, or to prohibit a *member’s* compliance with applicable laws and government regulations, (3) to prohibit review of a *member’s* professional practice under AICPA or state CPA society or Board of Accountancy authorization, or (4) to preclude a *member* from initiating a complaint with, or responding to any inquiry made by, the professional ethics division or trial board of the *Institute* or a duly constituted investigative or disciplinary body of a state CPA society or Board of Accountancy. *Members* of any of the bodies identified in (4) above and *members* involved with professional practice reviews identified in (3) above shall not use to their own advantage or disclose any *member’s confidential client information* that comes to their attention in carrying out those activities. This prohibition shall not restrict *members’* exchange of information in connection with the investigative or disciplinary proceedings described in (4) above or the professional practice reviews described in (3) above.

In order to remain compliant with AICPA Professional Ethics, the CPA should always obtain consent of the client, in writing, before releasing any confidential client information to a third party.

In determining how to respond to a request for information that can be provided, the CPA must determine the appropriate method of response. In many cases, an email with an attachment may suffice. Below are appropriate responses to various requests.

Request	Response
A third-party request for income tax returns of a client prepared by a CPA and electronically filed by a CPA.	<p>Via email</p> <p>Attached (enclosed) is the tax return for 2019 for John and Jane Doe, per your request. We prepared the tax return and electronically filed the tax return on April 11, 2023.</p> <p>(Keep in mind IRS rules related to electronic transmission of tax returns if you use email to respond. The return should be encrypted, and any passwords should be in a separate communication.)</p>
A third-party request for employment status of a client.	<p>While a CPA can perform an engagement under attest standards to determine the employment status of a client, in most cases such an engagement would be cost prohibitive. However, if a CPA performs the payroll function for the client, the following communication can be provided:</p> <p>Attached is a copy of a payroll check for Jane Doe that was prepared by our firm on June 17, 2023. The payroll check was prepared based on payroll information provided by ABC company for the payroll period ended June 15, 2023.</p>
A third-party request for verification of self-employment income	<p>Attached (enclosed) is a copy of the Schedule C (or E, if appropriate) and schedule SE that was prepared by our firm for John Doe for the tax year 2022. We electronically filed the tax return that contained these documents on March 19, 2023.</p> <p>(Keep in mind IRS rules related to electronic transmission of tax returns if you use email to respond. The return should be encrypted, and any passwords should be in a separate communication.)</p>

## Engagements under AICPA Professional Standards

In some instances, the type of information requested cannot be provided in a simple email or letter, but instead would require an engagement under various AICPA standards. The following standards may apply for certain situations:

### *United States Attestation Standards (AICPA)*

Attestation Standards are found in the AT-C section of the AICPA Professional Standards Volume 1. There are three levels of services that can be provided under Attestation Standards:

- Examination engagements
- Review engagements
- Agreed-upon procedures engagements

In all attestation engagements, the following preconditions are present:

- The CPA must be independent
- There is a responsible party other than the practitioner that accepts responsibility for the subject matter (the client)
- The following characteristics are present
  - The subject matter is appropriate
  - The criteria applied in the preparation and evaluation of the subject matter are suitable and will be available to the intended users
  - The CPA expects to be able to obtain the evidence needed to arrive for the opinion, conclusion, or findings
    - Access to all information of which the responsible party is aware that is relevant to the measurement, evaluation, or disclosure of the subject matter
    - Access to additional information that the CPA may request from the responsible party for the purposes of the engagement
    - Unrestricted access to persons within the appropriate parties from whom the CPA determines it is necessary to obtain evidence

All three types of engagements under the AT-C standards require engagement letters and representation letters.

The level of assurance provided for each type of engagement is as follows:

Engagement	Assurance Level
Examination	Reasonable/Opinion
Review	Limited/Conclusion
Agreed-upon Procedures	No assurance—Report findings

In most cases where a CPA determines an attest engagement is appropriate, the Agreed-Upon Procedures (AUP) engagement would be suitable. An AUP engagement typically is less expensive than an examination or a review engagement and will provide the comfort level requested by the third party. Common AUP engagements that will provide needed information include:

- *An engagement that determines the direct payments from an entity to the owner for a specified period (draws).* Often a lender will want to verify income via a W-2. For owners of small businesses, no W-2 is received, and the Schedule C income is distorted due to large depreciation deductions. In order to obtain a comfort level on cash flow, a CPA will be engaged to perform specific procedures to provide comfort to the lender on the cash that was withdrawn by a potential borrower. This information is then used by the lender to calculate sufficiency of cash flow based on historical draws.

- *An engagement that determines the amount of cash withdrawn from a business to pay taxes for flow-through entities.* Lenders sometimes are concerned with the level of cash in a pass-through tax entity at year end due to the typical timing of cash for tax payments [either the fourth-quarter estimate or taxes due at filing by the owner(s)]. Agreed-upon procedures can be performed to provide comfort on cash distributions made after year end and the amount of cash payments made by the owner(s) for tax payments after year end. Be sure to enumerate these as separate procedures as they may be independent of each other (i.e., the client withdraws \$20,000 to make an \$18,000 tax payment).

In the event that an AUP procedure will not suffice for a lender or other third party, consideration should be given to performing a review or examination engagement. However, due to the reasons for the desired level of assurance by the lender or third party, the CPA should consider the risks of such an engagement in light of the fees that may be collected. Because examination and review engagements are not as common as other engagements, quality control over such engagements also should be considered.

### ***Preparation, Compilation, and Review Standards (AICPA)***

Preparation, Compilation, and Review Standards are found in the AR-C Section of the AICPA Professional Standards Volume 2. While these standards are most often used for historical financial statements, the preparation and compilation standards may be used to issue prospective financial information in the form of forecasted or projected financial statements.

If a lender or third-party requests “comfort” on future earnings or cash flows, the CPA should make it clear that such assurance and representations cannot be provided. However, a CPA can provide prepared or compiled prospective financial information under AICPA Preparation and Compilation Standards.

Because preparation engagements do not require the CPA to provide a report with prospective financial information, it is highly advisable to compile prospective financial information. The compilation engagement requires a report, and the language in the compilation report should greatly decrease the risk that the lender or third party not understand that no assurance is provided on the prospective financial information.

AICPA standards require that a summary of significant assumptions be presented with the prospective financial information. Management is not permitted to omit such assumptions and have the CPA provide a paragraph in the compilation report that reports such an omission.

A CPA that performs a preparation or compilation of prospective financial information is required to comply with all of the requirements of the relevant AR-C section. Therefore, all procedures required in a preparation or compilation of historical financial statements must also be followed in a preparation or compilation of prospective financial information. This applies to engagement and acceptance procedures, including an engagement letter. The following is a sample engagement letter and sample report for a compilation of a forecasted statement of income for the next three years.

### ***Sample Engagement Letter***

To the appropriate representative of the engaging party:

You have requested that we perform a compilation engagement of the financial forecast of ABC Company (the Company), which comprises the forecasted income statements for the years ended December 31, 2023, 2024, and 2025, and the related summaries of significant assumptions. We are pleased to confirm our acceptance and our understanding of this engagement by means of this letter.

A financial forecast presents, to the best of management’s knowledge and belief, the Company’s expected results of operations for the forecast period. It is based on management’s assumptions reflecting conditions it expects to exist and the course of action it expects to take during the forecast period.

## Our Responsibilities

The objective of our engagement is to apply accounting and financial reporting expertise to assist you in the presentation of the financial forecast without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial forecast in order for it to be in accordance with guidelines for presentation of a forecast established by the American Institute of Certified Public Accountants (AICPA).

We will conduct our compilation engagement in accordance with Statements on Standards for Accounting and Review Services (SSARs) promulgated by the Accounting and Review Services Committee of the AICPA and comply with the AICPA's Code of Professional Conduct, including the ethical principles of integrity, objectivity, professional competence, and due care.

We are not required to, and will not, verify the accuracy or completeness of the information you will provide to us for the engagement or otherwise gather evidence for the purpose of expressing an opinion or a conclusion. Accordingly, we will not express an opinion or a conclusion nor provide any assurance on the financial forecast.

Our engagement cannot be relied upon to identify or disclose any misstatements in the financial forecast, including those caused by fraud or error, or to identify or disclose any wrongdoing within the Company or noncompliance with laws and regulations.

## Your Responsibilities

The engagement to be performed is conducted on the basis that you acknowledge and understand that our role is to assist you in the presentation of the financial forecast in accordance with guidelines for presentation of a financial forecast established by the AICPA. You have the following overall responsibilities that are fundamental to our undertaking the engagement in accordance with SSARs:

- a. The selection of accounting principles to be applied in the preparation of financial forecast
- b. The preparation and presentation of the financial forecast in accordance with guidelines for presentation of a forecast established by the AICPA, and the inclusion of all informative disclosures that are appropriate for the financial forecast under those guidelines
- c. The design, implementation, and maintenance of internal control relevant to the preparation and presentation of the financial forecast that is free from material misstatement whether due to fraud or error
- d. The prevention and detection of fraud
- e. To ensure that the Company complies with the laws and regulations applicable to its activities
- f. The accuracy and completeness of the records, documents, explanations, and other information, including significant judgments you provide to us for the engagement
- g. To provide us with:
  - i. Access to all information of which you are aware that is relevant to the preparation and presentation of the financial forecast, such as records, documentation, and other matters
  - ii. Additional information that we may request from you for the purpose of the compilation engagement
  - iii. Unrestricted access to persons within the Company of whom we determine it is necessary to make inquiries

## Our Report

As part of our engagement, we will issue a report that will state that we did not examine or review the financial forecast and that, accordingly, we do not express an opinion, a conclusion, nor provide any assurance on it. It will also state (1) that the forecasted results may not be achieved, and (2) that we assume no responsibility to update the report for events and circumstances occurring after the date of the report.

There may be circumstances in which the report differs from the expected form and content.

You agree to include our compilation report in any document containing the financial forecast that indicates that we have performed a compilation engagement on the financial forecast and, prior to inclusion of the report, to ask our permission to do so.

### Other Relevant Information

Our fees for these services...

Please sign and return the attached copy of this letter to indicate your acknowledgement of, and agreement with, the arrangements for our compilation of the financial forecast described herein, and our respective responsibilities.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant or accountant's firm]

Acknowledged and agreed on behalf of ABC Company by:

\_\_\_\_\_  
[Signed]

[Name and Title]

\_\_\_\_\_  
[Date]

### Accountant's Compilation Report on Prospective Financial Information

Management is responsible for the accompanying financial forecast of ABC Company, which comprises the forecasted statements of income for the years ending December 31, 2023, 2024, and 2025, and the related summaries of significant assumptions in accordance with guidelines for the presentation of a financial forecast established by the American Institute of Certified Public Accountants (AICPA). I (We) have performed a compilation engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. I (We) did not examine or review the financial forecast nor was (were) I (we) required to perform any procedures to verify the accuracy or completeness of the information provided by management. Accordingly, I (we) do not express an opinion, a conclusion, nor provide any form of assurance on this financial forecast.

The forecasted results may not be achieved as there will usually be differences between the forecasted and actual results, because events and circumstances frequently do not occur as expected, and these differences may be material. I (We) have no responsibility to update this report for events and circumstances occurring after the date of this report.

\_\_\_\_\_  
[Signature of practitioner's firm or practitioner, as appropriate]

\_\_\_\_\_  
[Practitioner's city and state]

\_\_\_\_\_  
[Date of the practitioner's report]

### Summary

The CPA plays a very important role in the lending process, and we have a desire to accommodate our clients when information or our expertise is requested. However, it is important to remember our responsibilities to the public and to not provide information that is not acceptable within our standards. By understanding the information requested and our applicable standards, the CPA can facilitate the lending process and inform both the client and the lender as to the limitations of what we can offer.

## GROUP STUDY MATERIALS

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### **A. Discussion Problems**

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1. Discuss your response if a lender asks your CPA firm to provide confirmation that a client was self-employed as of a specific date and verification of the client's self-employment income.
2. What is the first action a CPA should take when determining the appropriate response to a comfort letter request?
3. Discuss whether or not the requirements for preparing or compiling prospective financial information is different from the requirements for preparing or compiling historical financial statements.

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**B. Suggested Answers to Discussion Problems**

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1. Because the third party typically is requesting the representation as of a specific date, this is a representation that a CPA will want to avoid. To state that an individual was self employed as of a certain date is very tricky. The CPA would have to rely on the representation of the client that he or she was actively self employed as of a certain date. This is a representation that the lender can request directly from the client. Oftentimes, the lender may ask for a bank statement for the preceding month that would indicate the business activity of the self-employed person instead of requesting the assurance of a CPA.

Verification of income from self employment is very tricky as income is an amount that typically is presented on an income statement. When issuing reports on income statements, the CPA may compile, review, or audit. None of these services provide a report in which the CPA “verifies” the net income. The level of assurance provided would, of course, be dictated by the type of engagement that is agreed to by the CPA and client. In most cases, the client does not want to pay for an audit or review, neither of which would provide the “verification” requested by the third party.

2. When determining how to respond to comfort letter requests, the CPA should first determine if the request is appropriate and can be provided under standards. If the requested information is for an assurance that is prohibited (such as future performance), then the required action is to not provide the requested assurance and inform the third party and the client of the reason for the non-response. This is a courtesy; it is not required by standards.
3. A CPA that performs a preparation or compilation of prospective financial information is required to comply with all of the requirements of the relevant AR-C section. Therefore, all procedures required in a preparation or compilation of historical financial statements must also be followed in a preparation or compilation of prospective financial information. This applies to engagement and acceptance procedures, including an engagement letter.



## GLOSSARY OF KEY TERMS

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**Audit Risk**--the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated

**Comfort Letters**--a letter issued by an auditor in accordance with AU-C section 920 to requesting parties in connection with an entity's financial statements included in a securities offering; however, the requests that CPAs are actually receiving from third parties pertain to verification letters. The requested information may relate to a pending loan, employee medical insurance, child adoption applications, or use-tax certification.

**Control Risk**--the risk that the internal control arrangements will fail to prevent material deviations, or to detect and correct them on a timely basis

**Inherent Risk Factors**--characteristics of events or conditions that affect the susceptibility to misstatement, whether due to fraud or error, of an assertion about a class of transactions, account balance, or disclosure, before consideration of controls

**Risk Assessment**--identification and assessment of risk of material misstatement

**Reverse Factoring**--reverse factoring occurs when a finance company, such as a bank, interposes itself between a company and its suppliers and commits to pay the company's invoices to the suppliers at an accelerated rate in exchange for a discount. This is a lower-cost form of financing that accelerates accounts receivable receipts for suppliers.

**SOFR**--Secured Overnight Funding Rate

**SSARS**--Statement on Standards for Accounting and Review Services

**Structured Payable Arrangements**--arrangements that may look like accounts payable, but are really short term debt as there is an intermediary party providing financing

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Jennifer Louis .....	Jan-Jul	Russ Madray .....	Jan-May, Jul
Kurt Oestricher .....	Feb-Jul		

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

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1. According to Russ Madray, what is one benefit of structured payable arrangements, vendor payable programs, reverse factoring, and other arrangements that allow intermediaries to purchase trade receivables held by suppliers for goods and services sold on credit to buyers?
  - A. Buyers are required to pay for the goods and services before the invoice date.
  - B. Suppliers are able to eliminate or reduce their credit exposure.
  - C. Buyers do not have to pay transaction fees, charges, etc., to the intermediaries.
  - D. Processing administration is more time-consuming for buyers and suppliers.
2. According to Russ Madray, which of the following is one characteristic of a supplier financing program for which disclosures are required under ASU 2022-04?
  - A. A finance provider or intermediary must be involved in the arrangement.
  - B. The supplier must confirm that the invoices they sent to the buyer are valid.
  - C. The buyer must be willing to make early payments to the supplier.
  - D. The program's payment terms must include pledged assets or other types of guarantees.
3. According to Russ Madray, what is the purpose of ASU 2022-5?
  - A. It delays the sunset date for the release of information related to LIBOR found in Topic 848 to December 31, 2024.
  - B. It extends the method for qualifying tax equity investments that generate tax credits provided by the Emerging Issues Task Force (EITF) to tax equity investments from other types of tax credit programs.
  - C. It reduces some of the cost and complexity related to accounting for long-duration contracts by allowing insurance entities to make accounting policy elections.
  - D. It clarifies how related business entities in a common control arrangement determine whether leases exist and how to account for leasehold improvements.
4. According to Russ Madray, the practical expedient provided in ASU 2023-1 applies to what type(s) of entities?
  - A. Nonprofit organizations
  - B. Public companies
  - C. Private companies and certain public companies
  - D. Private companies and certain nonprofit organizations
5. According to Russ Madray, what FASB guidance allows reporting entities to account for their qualifying tax equity investments using the proportional amortization method regardless of what type of program gave rise to the investment tax credits?
  - A. ASU 2022-04
  - B. ASU 2022-05
  - C. ASU 2022-06
  - D. ASU 2023-02

*Continued on next page*

6. According to Jennifer Louis, SAS No. 145 is effective for calendar-year audits starting in what year?
- A. 2022
  - B. 2023
  - C. 2024
  - D. 2025
7. According to Jennifer Louis, does SAS No. 145 rewrite the basic audit risk model?
- A. No, SAS No. 145 does not change the basic audit risk model.
  - B. No, but SAS No. 145 creates a more thought-based application process for applying the basic model.
  - C. Yes, SAS No. 145 changes the basic audit risk model to eliminate the concept of control risk.
  - D. Yes, SAS No. 145 is a full rewrite of the basic audit risk model including new terms and procedures.
8. According to Jennifer Louis, what is one enhancement SAS No. 145 made to the concept of inherent risk?
- A. It introduced the concept of *inherent risk factors* as part of an auditor's risk assessment.
  - B. It allows inherent risk to be assessed as low for assertions that are easy to audit.
  - C. It allows auditors to consider an audit area's inherent risk at the same time as its related controls.
  - D. It limits an auditor's assessment of inherent risk to quantitative terms, excluding qualitative terms.
9. According to Jennifer Louis, are auditors still required to assess risk at the relevant assertion level?
- A. No, assessing risk at the relevant assertion level is prohibited under SAS No. 145.
  - B. No, this requirement was removed by SAS No. 145, but auditors can still elect to do so.
  - C. Yes, assessing risk at the relevant assert level continues to be a requirement under SAS No. 145.
  - D. Yes, but only for assertions that reach the specific quantitative threshold provided in SAS No. 145.
10. According to Jennifer Louis, which of the following statements best describes the concept of inherent risk under SAS No. 145?
- A. Smaller entities always have a lower level of inherent risk regardless of their nature and the complexity of their operations and their accounting systems.
  - B. It is no longer important to have a thorough understanding of the entity and its environment before assessing inherent risk.
  - C. If it is more cost effective, it is now appropriate for auditors to combine their assessments of inherent and control risk.
  - D. Inherent risk falls on a spectrum—a sliding scale that can be described as low/medium/high, numerically, or using some other methodology.

*Continued on next page*

11. According to Kurt Oestrieher, CPAs should never write comfort letters about which of the following?
  - A. Historical events
  - B. Future events or future implications of current events
  - C. Verifiable facts and information
  - D. Information of interest to third parties
12. According to Kurt Oestrieher, if assurance will be provided, what standards should U.S. CPAs typically consult for guidance on how to perform comfort letter engagements?
  - A. The generally accepted auditing standards.
  - B. The Internal Revenue Code.
  - C. The attestation standards.
  - D. International audit and assurance standards
13. According to Kurt Oestrieher, a comfort letter that provides no assurance is most similar to what type of engagement?
  - A. An agreed-upon procedures engagement
  - B. A review engagement
  - C. An examination engagement
  - D. An audit engagement
14. According to Kurt Oestrieher, what type of engagement is most appropriate for a client who wants assurance on forecasted or projected financial information?
  - A. A comfort letter
  - B. A compilation
  - C. A review
  - D. An audit
15. According to Kurt Oestrieher, how should CPAs respond when clients ask them to provide a comfort letter to a third party?
  - A. They should agree because the most important thing is to keep their clients happy.
  - B. They should agree so they can keep up their reputations as problem solvers.
  - C. They should say no because the standards do not provide specific procedures for comfort letters.
  - D. They should start by saying no, but if the client insists they can discuss appropriate options.

## Subscriber Survey Evaluation Form

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

How would you rate the topics covered in the July 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
FASB Update	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Transition Issues with SAS 145	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>
Comfort Letters	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>	<input type="text"/>

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

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

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

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

	<b>Overall</b>	<b>Knowledge of Topic</b>	<b>Presentation Skills</b>
Russ Madray			
Jennifer Louis			
Kurt Oestrieher			

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

Are you using **CPE Network® A&A Report** for: CPE Credit ☐ Information ☐ Both ☐

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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 ☐

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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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Name/Company \_\_\_\_\_

Address \_\_\_\_\_

City/State/Zip \_\_\_\_\_

Email \_\_\_\_\_

**Once Again, Thank You...**

**Your Input Can Have a Direct Influence on Future Issues!**

**CPE Network®**

Firm/Company Name: \_\_\_\_\_

Account #:

**Location:**

Program Title: \_\_\_\_\_ Date: \_\_\_\_\_

[illegible]

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

Instructor Name: \_\_\_\_\_

Date: \_\_\_\_\_

E-mail address:

License State and Number:

# CPE Network/Webinar Delivery Tracking Report

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

[illegible]

# CHECKPOINT LEARNING NETWORK

# CPE NETWORK®

# USER GUIDE

REVISED 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](mailto:CPLgrading@tr.com)

**Fax:** 888.286.9070

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

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

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

# “Group Internet Based” Format

## CPE Credit

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

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

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

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

## Advertising / Promotional Page

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

## Monitoring Attendance in a Webinar

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

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

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

Examples of polling questions:

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

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

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

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

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

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

### **Make-Up Sessions**

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

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

### **Awarding CPE Certificates**

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

### **Subscriber Survey Evaluation Forms**

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

## **Retention of Records**

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

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

## **Finding the Transcript**

**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](mailto: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:

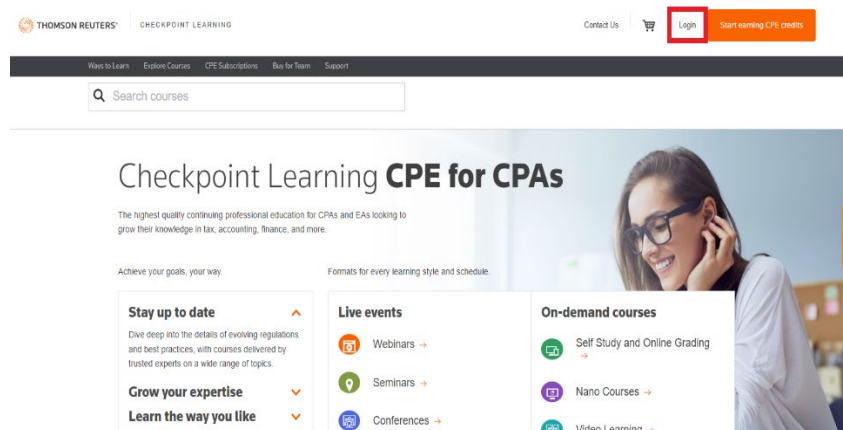
- Watch the DVD.
- Review the supplemental materials.
- Read the discussion problems and the suggested answers.
- Complete the quizzer by filling out the bubble sheet enclosed with the transcript package.
- Complete the survey. We welcome your feedback and suggestions for topics of interest to you.
-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

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

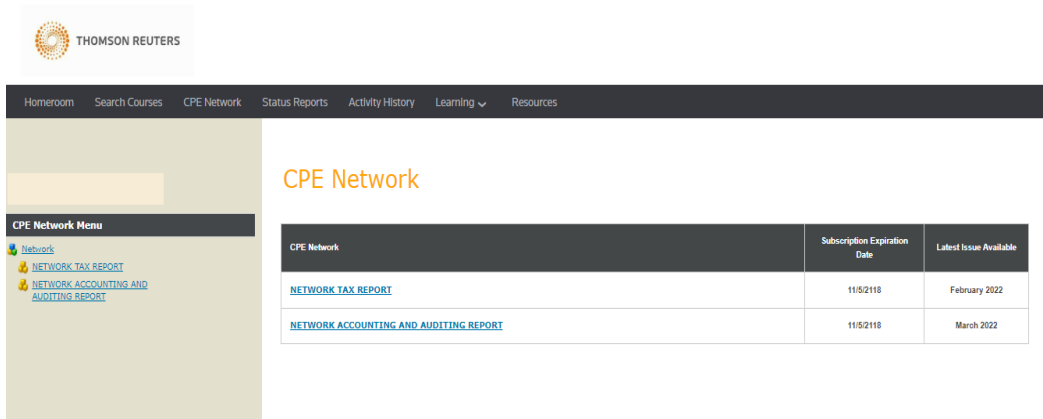
## Self-Study—Online

Follow these simple steps to use the online program:

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

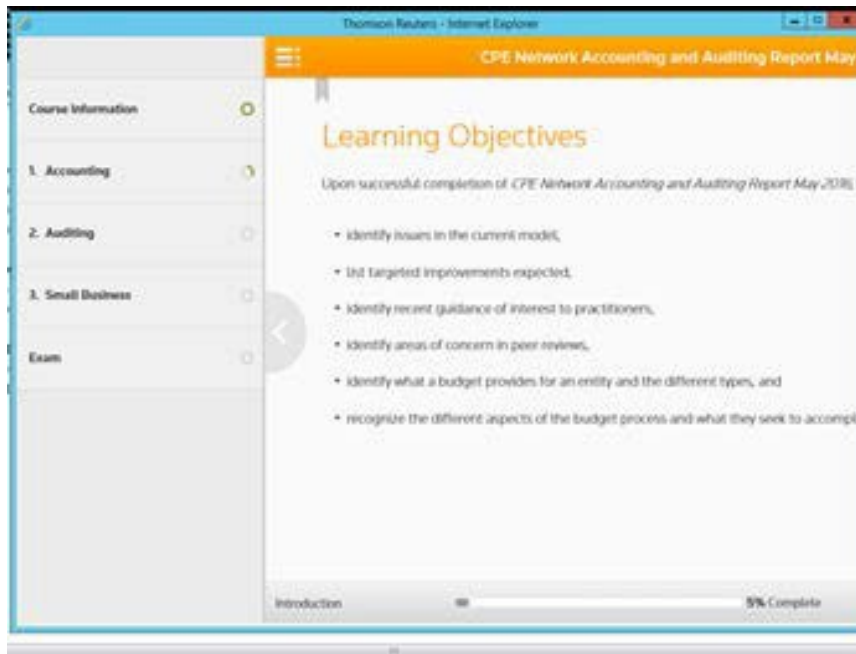


- In the **CPE Network** tab, select the desired Network Report and then the appropriate edition.



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

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



Thomson Reuters - Internet Explorer

CPE Network Accounting and Auditing Report May 2018

## Learning Objectives

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

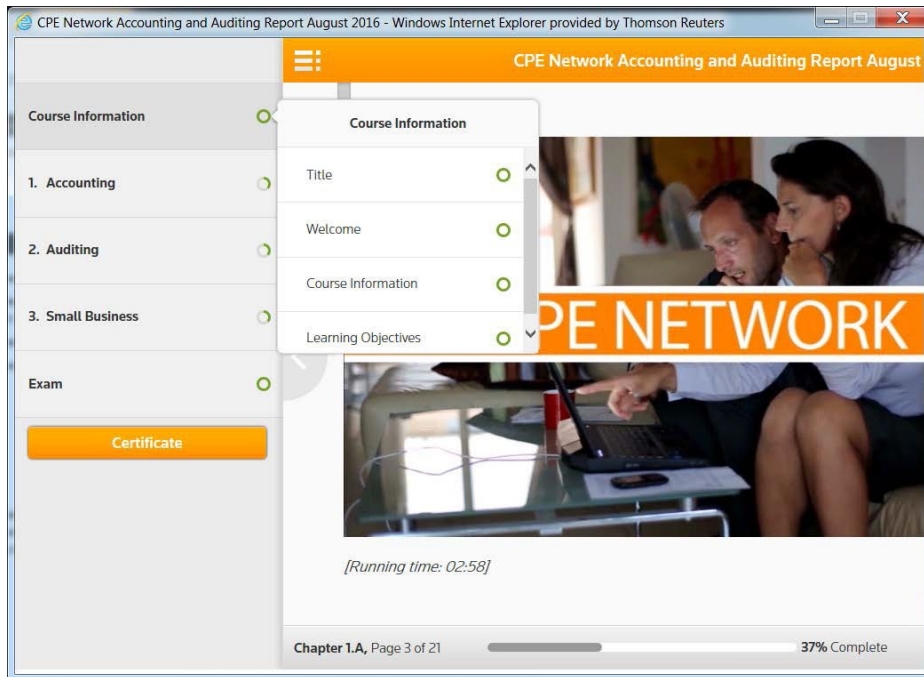
- identify issues in the current model;
- list targeted improvements expected;
- identify recent guidance of interest to practitioners;
- identify areas of concern in peer reviews;
- identify what a budget provides for an entity and the different types; and
- recognize the different aspects of the budget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

Introduction 5% Complete

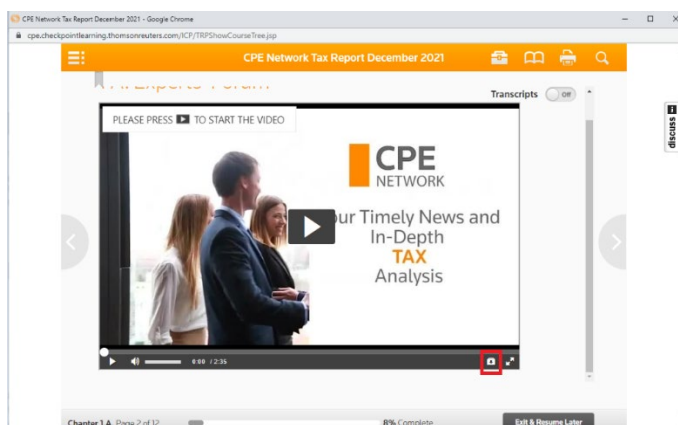
Click down to access the dropdown menu and move between the program Chapters.



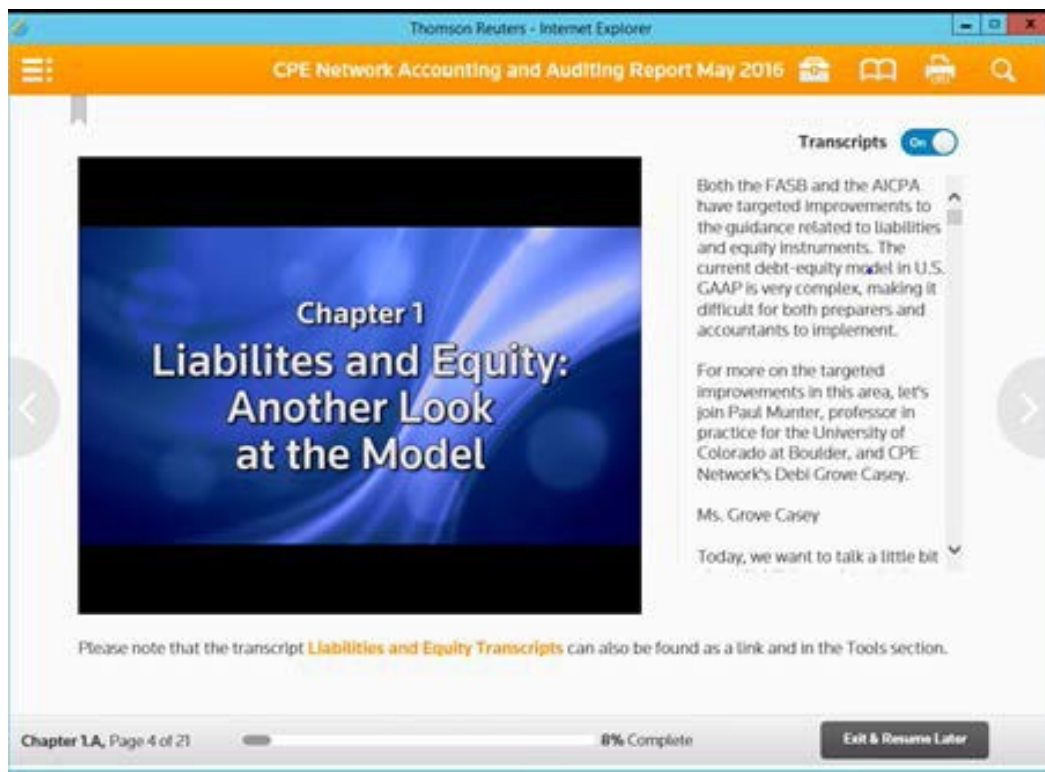
- **Course Information** is the course Overview, including information about the authors and the program learning objectives



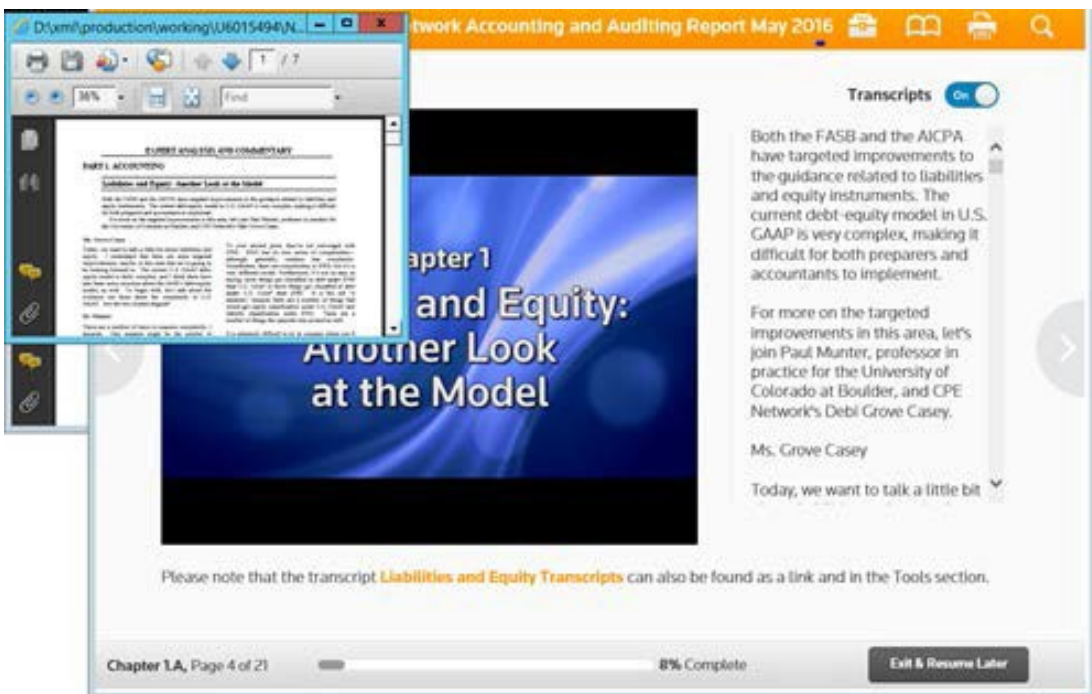
- **Each Chapter is now self-contained.** Years ago, when on the CPEasy site, the interview segments were all together, then all the supplemental materials, etc. Today, each chapter contains the executive summary and learning objectives for that segment, followed by the interview, the related supplemental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



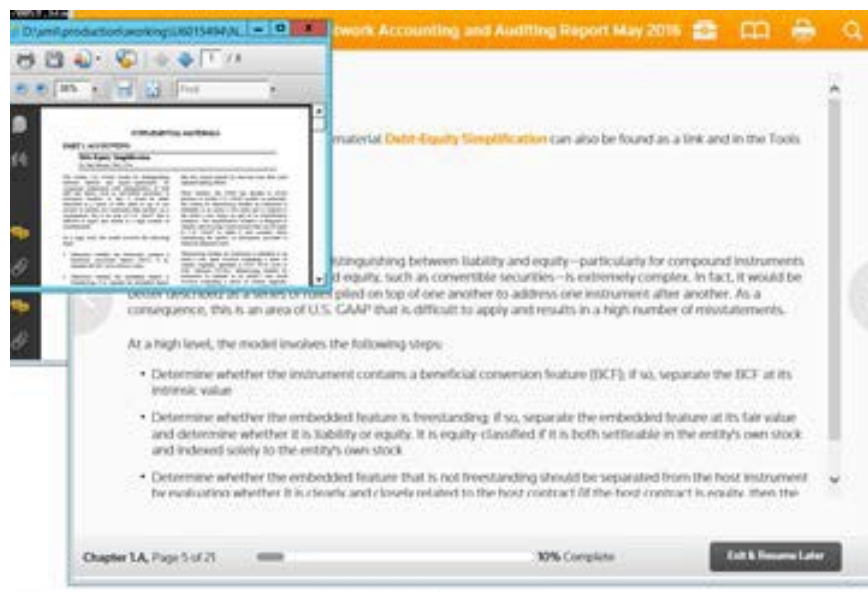
Video segments may be downloaded from the CPL player by clicking on the download button. Tip: you may need to scroll down to see the download button.



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'. It contains three numbered items: 1. ASC 320 requires that, at acquisition, an enterprise classify debt and marketable equity securities into one of three categories: Held-to-maturity, Trading, and Available-for-sale. 2. The trading securities category includes securities that are bought and held principally for the purpose of selling them in the short term. 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. At the bottom, it says 'Chapter 3.A, Page 20 of 20', '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'. It contains the text: 'You have completed the exam for this course. Please choose your next course of action by selecting on one of the buttons below.' There are two orange buttons: 'Review My Answers' and 'Grade My Answers'. At the bottom, it says 'Course, Completed', '100% Complete', and an 'Exit & Resume Later' button.

**Course Exams Completed**

You have completed the exam for this course.

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

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

**Review My Answers**

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

**Grade My Answers**

Course, Completed      100% Complete      Exit & Resume Later

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

### **Additional Features Search**

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

**Search Results** are displayed with the number of hits.

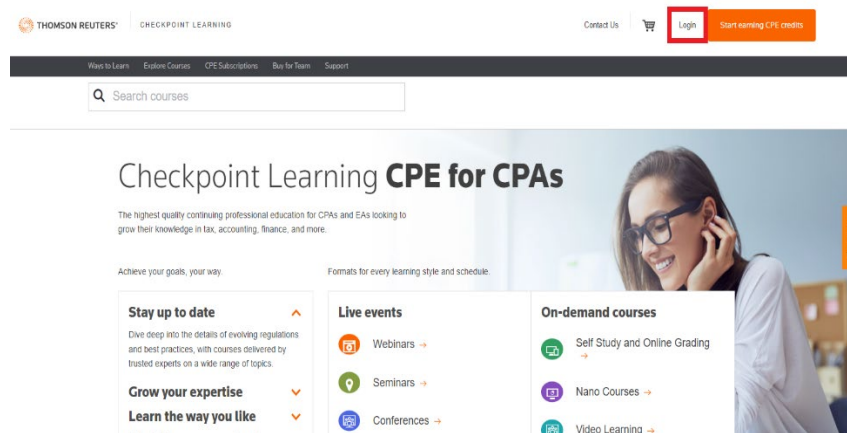
### **Print**

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

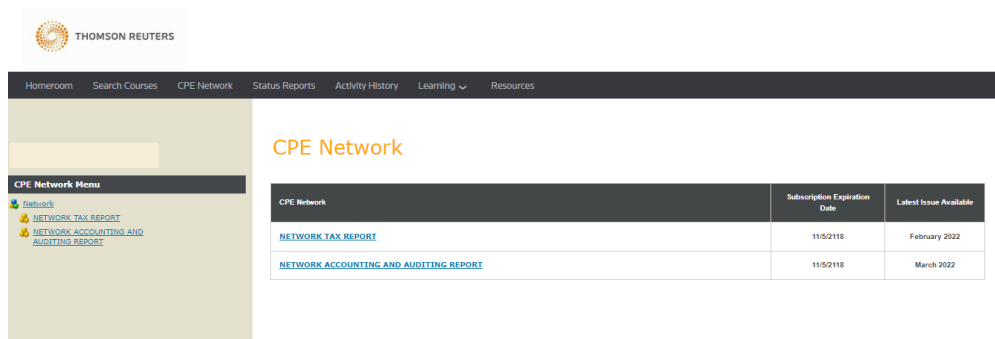
# Transitioning From DVDs

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

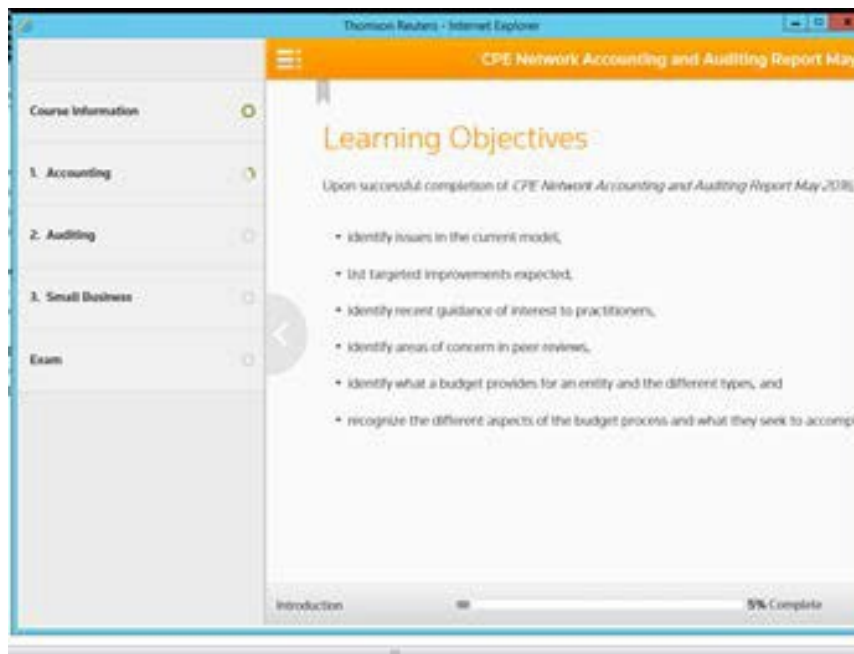
- Go to [www.checkpointlearning.thomsonreuters.com](http://www.checkpointlearning.thomsonreuters.com) .
- Log in using your username and password assigned by your firm's administrator in the upper right-hand margin ("Login").



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



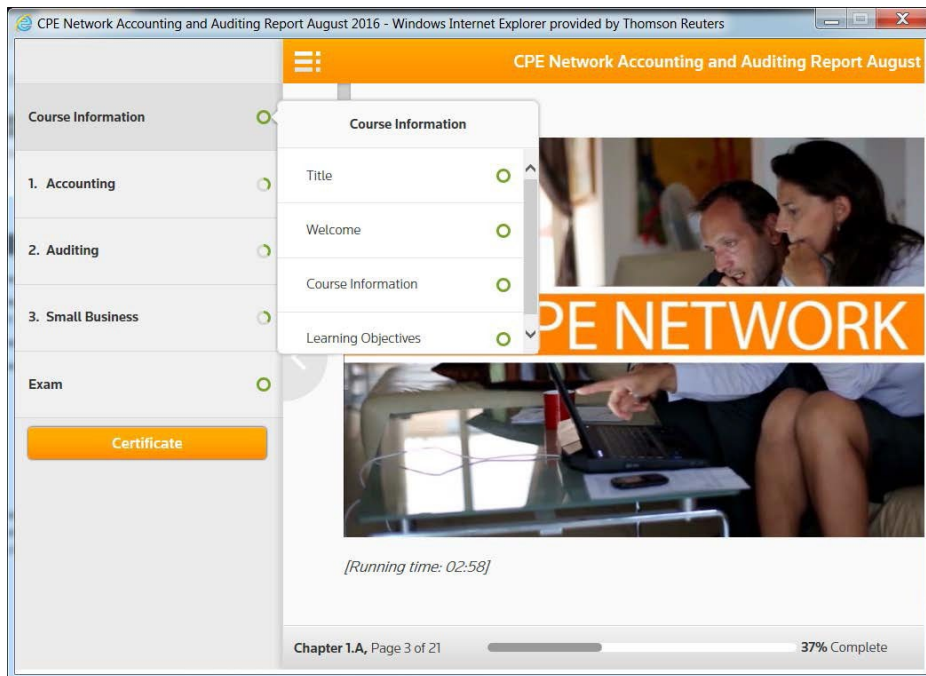
The Chapter Menu is in the gray bar at the left of your screen:



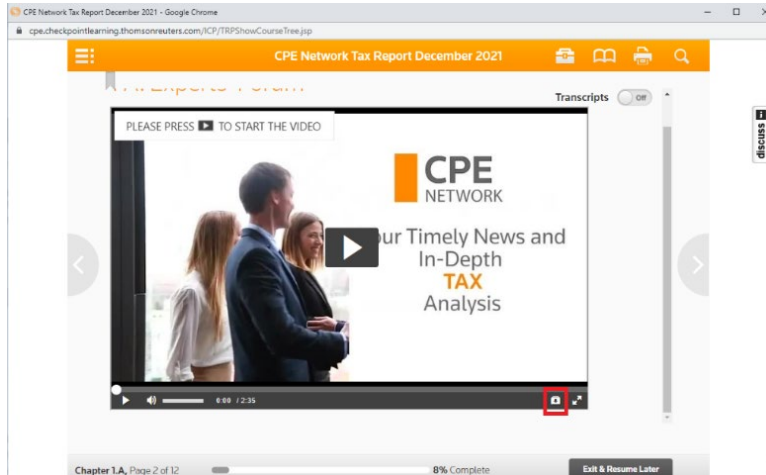
Click down to access the dropdown menu and move between the program Chapters.

- **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.

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

# Getting Help

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

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